No. 83-1618

In the Supreme Court of the United States

OCTOBER TERM, 1983

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

TENNECO OIL COMPANY, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether the sale by a natural gas producer to an interstate pipeline of a leasehold interest in proven gas reserves for use by the pipeline in supplying its interstate customers, which sale is in all significant respects the economic equivalent of a conventional wellhead sale, is a "sale in interstate commerce of natural gas for resale" within the jurisdiction of the Federal Energy Regulatory Commission under Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b).

PARTIES TO THE PROCEEDING

Public Agencies:

Federal

Federal Energy Regulatory Commission

State

People of the State of California
Public Utilities Commission of the State of California
Idaho Public Utilities Commission
Public Service Commission of Nevada
Public Utility Commissioner of Oregon
Washington Utilities & Transportation Commission
Public Service Commission of Wyoming

City

City of Ellensburg, Washington

Interstate Natural Gas Pipeline Companies:

El Paso Natural Gas Company
Northwest Pipeline Corporation

Distribution Companies:

Cascade Natural Gas Corporation
Colorado Interstate Gas Company
CP National Corp.
Intermountain Gas Company
Mountain Fuel Supply Company
Northwest Natural Gas Company
Pacific Gas and Electric Company
Rocky Mountain Natural Gas Company

San Diego Gas & Electric Company
Southern California Edison Company
Southern California Gas Company
Southern Union Company
Southwest Gas Corporation
Washington Natural Gas Company
Washington Water & Power Company

Producers:

El Paso's System	Party
GLA 47	Tenneco Oil Company Conoco, Inc.
GLA 51	Mapco, Inc. Hopi Oil Company
GLA 52	Tenneco Oil Company Conoco, Inc. Union Oil Company of California New York Life Insurance Company
GLA 60	Tenneco Oil Company Conoco, Inc. Charles Colwill Anne Home Emerson, Trustee Ina Belle Hightower Anna Lou Home Jean E. Keyser Cassandra Keyser Teresa Home Barron Kidd W. H. and Alberta A. Sloan Helen Ulmer van Atta
GLA 61	Sun Oil Company (Delaware)

El Paso's System	Party
GLA 62	FHN, Ltd.
GLA 63	Atlantic Richfield Company
GLA 66	W. Watson LaForce, Jr. Henry P. Isham, Jr. Estate Robert T. Isham Josephine C. Jacobson J. Roberts Jones Nancy LaForce Keyes Frederic P. G. Lattner, Trustee U/T Martha M. Lattner, Settlor Suzanne LaForce Baber James C. Bard Douglas N. Bard Ralph A. Bard, Jr. Roy E. Bard, Jr. G. R. Brainard, Jr. Trust Continental Illinois National Bank and Trust Company of Chicago, Trustee Trust #23935 Continental Illinois National Bank and Trust Company of Chicago, Trustee Trust #23949 Eleanor Isham Dunne Charles W. Farnham, Jr. Robert B. Farnham Walter B. Farnham Elizabeth B. Farrington Minnie A. Fitting R. U. Fitting, Jr. Estate Robert D. Fitting Nancy H. Gerson John R. Grimes Jay C. Halls and Ruth N. Halls, Trustees

El Paso's System	Party
	Ruth N. Halls
	Cortland T. Hill
	Elsie F. Hill
	Louis W. Hill, Jr.
	Albert L. Hopkins, Jr.
	George S. Isham
	R. S. MacDonald, A. MacDonald and Northern Trust Co., Trustees U/W of N. S. MacDonald, Deceased
	Mary F. Love
	William J. McDermott, Trustee
	Nora R. Ranney
	Catherine H. Ruml
	Edward L. Ryerson, Jr.
	Sabine Royalty Corporation
	Shaw, Isham & Company
	John I. Shaw, et al., Trustees
	Elizabeth B. Simpson Trust
	James Simpson, Jr. Trust
	William E. Simpson Trust
	Sydney Stein, Jr.
	Northern Trust Co., Trustee U/W of John Stuart
	Robert Douglas Stuart Estate
	William P. Sutter
	Michael Simpson Trust
	Patricia Simpson Trust
	Kay B. Towle
	Katharine I. White
	Kay B. Gundlach
	F. F. Webster Revocable Trust
	Frederick W. Webster
	Mary S. Zick

El Paso's System	Party
	David Waller Dangler
	Ralph U. Fitting, III, Executor of Estate of R. U. Fitting, Jr., Deceased
	J. Robert Jones, Executor of Estate of R. U. Fitting, Jr., Deceased
GLA 72, 86, 101, 127	Mapco, Inc. Hopi Oil Company
GLA 76	Union Oil Company of California
	First National Bank of Ft. Worth, Trustee for Eula May Johnston
	James J. Johnston
	Alvin C. Johnson, Trustee
	V. A. Johnson Family Trust
	Jones Company
	Wm. C. McMahan Estate
	Homer R. Stasney & Sons Company
	Rogers-Gibbard Trust
	Robert Beamon
	Thomas L. Hale
	Pattie Anne Beamon Lundell
	Orville Curtis Rogers, Trustee
	Veva Jane Gibbard, Trustee
GLA 77	Robert Beamon
	Robert Beamon, Trustee
	Pattie Ann Beamon Lundell
	Thomas L. Hale, Trustee
	First National Bank of Ft. Worth, Trustee for Eula May Johnston
	Rogers-Gibbard Trust
	James J. Johnston
	Alvin C. Johnson, Trustee

El Paso's System	Party
	V. A. Johnston A. V. Jones Company W. C. McMahan Homer R. Stasney
GLA 78	American Petrofina Company Tenneco Oil Company Conoco, Inc. Union Oil Company of California
GLA 106	Morris and Flora Mizel
GLA 122	Producing Royalties, Inc. Harold S. Long Dixie M. McLane Trust Mrs. Judy St. John Taylor John S. White
GLA 125	American Petrofina Company Anderson Construction Company, Inc. Benson-Montin-Greer Drilling Corp. Tom Bolack Oliver Benson Albert R. Greer Mary Eddy Jones Edna Fern Benson Walter Benson Charlene K. Greer Mary E. Jones and The First National Bank & Trust Company of Oklahoma City, Trustees U/W of F. Jones Late Oil Company A. C. Montin, Jr. William V. Montin Oklahoma and Northwestern Company

El Paso's System	Party
GLA 129	Delta Drilling Company Trustees of the DeGolyer Foundation Mrs. Nell V. Golyer 3-M Oil Company
GLA 139	Producing Royalties, Inc. James A. and Hazel H. Borland R. Lewis Chandler Trust Mary C. Fannin Charles E. Graham, Jr. Lewis Chandler Mrs. Carrie B. Graham Newell R. Hays Dixie M. McLane Grandchildren's Trust Critchell Parsons Judy St. John Taylor
GLA 152, 160, 231	J. Glenn Turner Sue Reeder Turner Trust William G. Webb
GLA 153	Gretchen A. Gartner Helen L. Harvey
GLA 157	Mapco, Inc. Barbara Ann Bruss O. J. Lilly Barbara Irene McConnell
GLA 172	Crown Central Petroleum Corporation
GLA 195	William G. Webb J. Glenn Turner
GLA 196	J. Glenn Turner Sue Reeder Turner Trust William G. Webb

El Paso's System	Party
	Benson-Montin-Greer Drilling Corp. Barbara Ann Bruss Charles Albert Greer La Plata Gathering System, Inc. O. J. Lilly Huerfanito Gas Co., et al. Barbara Irene McConnell Mary R. Boecking and H. E. Boecking, Jr., Trustees U/T of Mary M. Strachley Jacqulyn M. Williams
GLA 197	Huerfanito Drilling Company, Inc.
GLA 198, 248	J. Glenn Turner Sue Reeder Turner Trust William G. Webb Frank A. Schultz
GLA 249	Benson-Montin-Greer Drilling Corp. Barbara Ann Bruss Charles Albert Greer La Plata Gathering System, Inc. O. J. Lilly Barbara Irene McConnell Mary R. Boecking and H. E. Boecking, Jr., Trustees U/T of Mary M. Strachley J. Glenn Turner Sue Reeder Turner Trust Jacqulyn M. Williams
GLA 348	Union Oil Company of California Jones Company W. C. McMahan

El Paso's System	Party
	H. R. Stasney & Sons Company Alvin C. Johnson, Trustee
GLA 349	Union Oil Company of California A. V. Jones Co. W. C. McMahan Homer R. Stasney Robert Beamon and Robert Beamon, Trustee
GLA 350, 351	Robert Beamon Robert Beamon, Trustee Thomas L. Hale, Trustee Pattie Anne Beamon Lundell

Northwest's System	Party
PLA 2	Atlantic Richfield Company
PLA 3	Getty Oil Company
PLA 4	Grace M. Brown Catherine B. McElvain, Inc. and as Executrix of Estate of T. H. McElvain, Deceased T. H. McElvain Oil and Gas Properties James E. McElvain, Executor of Estate of Carl R. McElvain J. Wm. McElvain Estate of F. B. Miller Mabelle McElvain Miller Mrs. Ruth M. Vaughn
PLA 5	Phillips Petroleum Company
PLA 6	Amoco Production Company J. Ralph Ellis, Jr.

Northwest's System	Party
	Jones Felvey, II First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr. McCulloch Oil Corporation Mountain States Natural Gas Corp. John D. Mugg, Jr. Jack B. Ryan Texas Oil & Gas Corp. U.V. Industries
PLAs 7, 9, 10, 11	Amoco Production Company
PLA 8	J. Ralph Ellis, Jr. Jones Felvey, II First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr. H. M. Meredith, Trustee, and First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr. Mountain States Natural Gas Corp. John D. Mugg, Jr. Amoco Production Company Jack B. Ryan Texas Oil & Gas Corp.
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PLA 14	Champlin Petroleum Co.

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v.

TENNECO OIL COMPANY, ET AL.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the Federal Energy Regulatory Commission, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-19a)[1] is reported at 708 F.2d 1011. The orders of the Federal Energy Regulatory Commission (Pet. App. 21a-31a, 153a-154a) are reported at 12 F.E.R.C. ¶ 61,297 and 13 F.E.R.C. ¶ 61,239, respectively. The decision of the administrative law judge (Pet. App. 33a-120a) is reported at 6 F.E.R.C. ¶ 63,037. The

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[1] "Pet. App." refers to the appendix to the petition in No. 83-1321.

opinion of the district court (Pet. App. 121a-136a) is reported at 426 F. Supp. 963.

JURISDICTION

The judgment of the court of appeals (Pet. App. 145a-149a) was entered on July 5, 1983. Petitions for rehearing were denied on December 2, 1983 (Pet. App. 151a-152a). Justice White extended the time for filing a petition for a writ of certiorari to and including April 2, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and 15 U.S.C. 717r(b).

STATUTE INVOLVED

Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), provides:

> The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

STATEMENT

A. Regulatory Background

This Court is familiar with the history of the Natural Gas Act, 15 U.S.C. 717 *et seq.* Prior to the enactment of that Act, the Court had held, in a series

of cases, that the Commerce Clause barred the states from regulating sales of natural gas for resale in interstate commerce. As a result of these rulings, wholesale gas transactions in interstate commerce were left entirely unregulated. The overriding purpose of Congress in the Natural Gas Act was to close this regulatory gap. In Section 1(b) of the Act, 15 U.S.C. 717(b), the Commission[2] is given jurisdiction over natural gas companies engaged in the transportation or sale of natural gas for resale in interstate commerce, but not over the "production or gathering" of natural gas. Natural gas companies subject to Commission jurisdiction under the Act are required to obtain from the Commission certificates of public convenience and necessity before they may engage in such sales (15 U.S.C. 717f(c)) and the rates they charge for such sales must be just and reasonable (15 U.S.C. 717c).

In *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), this Court held that conventional wellhead sales of natural gas by an independent producer to an interstate pipeline for resale in interstate commerce did not fall within the "production or gathering" exemption but were subject to Commission jurisdiction under the Natural Gas Act. Thereafter, in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965) (commonly referred to as the "*Rayne Field*" case), the Court held that sales of gas leases from a "proven and substantially developed" field, which accomplish the transfer of large volumes of natural gas to an interstate pipeline com-

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[2] Both the Federal Energy Regulatory Commission and its predecessor agency, the Federal Power Commission, are referred to herein as the "Commission".

pany for resale in the interstate market, are likewise within the Commission's jurisdiction under the Act.[3]

B. Factual Background

1. In 1948, six years before *Phillips* and 17 years prior to *Rayne Field*, El Paso Natural Gas Company (El Paso), an interstate pipeline, entered into a contract with Delhi Oil Corporation (Delhi) to purchase gas produced by Delhi at Barker Dome in northwestern New Mexico, near the San Juan Basin. The history of the Barker Dome transaction is detailed in the decision of the administrative law judge (Pet. App. 44a-51a). For present purposes, it is sufficient to note that, before the contract became effective, Delhi became concerned that a conventional wellhead sale, such as that proposed in its contract with El Paso, might be subject to regulation by the Commission. Accordingly, Delhi, acting upon advice of counsel, insisted that the transaction be recast in lease-sale form (Pet. App. 49a-50a).[4] This new arrangement placed Delhi and El Paso in about the same economic position each would have enjoyed under a conventional wellhead sales contract.

Thereafter, Delhi and other producers acquired control over vast amounts of proven gas reserves in

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[3] These cases and others are discussed in greater detail at pages 11-19, *infra*.

[4] The lease-sale agreement in *Rayne Field*, like that at Barker Dome, was adopted as a substitute for a conventional wellhead sales contract. See page 12, *infra*. In his initial decision, the administrative law judge observed that "[t]he Barker Dome dealings * * * probably represented a more blatant attempt to evade Federal regulation than the scheme which occurred in the *Rayne Field* case" (Pet. App. 105a).

the San Juan Basin (Pet. App. 56a-57a).[5] Again, following advice of counsel, Delhi insisted on selling its reserves to El Paso under a lease-sale agreement (*id.* at 60a). In an agreement designated GLA-47,[6] Delhi transferred in place to El Paso an estimated 1.063 trillion cubic feet of gas (R. 9692).[7] The parties anticipated that 179 billion cubic feet would be extracted from the properties during the first four years (*ibid.*). Shortly after the closing of GLA-47 in March of 1952, El Paso began taking into its interstate system large volumes of natural gas from the San Juan field (Pet. App. 60a; R. 5241-5246).

Subsequently, other San Juan Basin producers transferred their reserves to El Paso under similar lease-sale agreements. In all, El Paso entered into some 36 lease-sale agreements in the San Juan Basin (35 of which are in issue here), acquiring gas underlying more than a quarter of a million acres (Pet. App. 61a).

2. In 1952, Pacific Northwest Pipeline Corporation (PNW), the predecessor of respondent Northwest Pipeline, sought Commission authorization to

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[5] By 1950, the San Juan Basin was already known as one of the major fields of gas in place in North America (R. 9936; Pet. App. 52a-55a). ("R." refers to the record in the court of appeals.)

[6] "GLA" refers to the producer lease-sale agreements with El Paso. "PLA" refers to the producer lease-sale agreements with the predecessor of Northwest Pipeline Corporation (Northwest).

[7] The Commission relied on these reserves in authorizing El Paso to expand its pipeline facilities at an estimated capital cost of about $46 million. *El Paso Natural Gas Co.*, 11 F.P.C. 1071, 1074 (1952).

construct an interstate pipeline system from the San Juan Basin to the Pacific Northwest. In attempting to secure reserve dedications to support its application before the Commission, PNW offered the various Basin producers the option of either a conventional wellhead sale of natural gas or a sale of reserves in place (Pet. App. 74a-75a).

In 1953, PNW and Phillips Petroleum Company (Phillips) executed a conditional lease-sale agreement for the transfer of gas in place (PLA-5), covering about 200,000 acres in the Basin and an estimated three trillion cubic feet of gas (Pet. App. 75a). The Phillips-PNW contract was contingent on PNW's receipt of a Commission certificate to construct its proposed pipeline and on PNW's obtaining satisfactory financing commitments from a reputable financial institution (*id.* at 77a).

Thereafter, other San Juan Basin producers entered into similar conditional agreements with PNW (Pet. App. 77a-82a). In 1954, the Commission granted PNW a certificate authorizing it to construct its pipeline system into the Pacific Northwest.[6] The Commission subsequently approved PNW's financing plan, thereby permitting PNW to close its conditional gas agreements. On September 1, 1956, construction of the PNW pipeline was completed and natural gas began to flow from the San Juan Basin to consumers in the Pacific Northwest (*id.* at 82a).

3. In most respects, the terms of the above described lease-sale agreements were similar. The agreements called for the pipelines to compensate the interest owner of the acreage by paying a special

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[6] *Northwest Natural Gas Co.*, 13 F.P.C. 221 (1954).

"overriding royalty." [9] The royalty was to be calculated as a specified sum per Mcf of gas produced from the acreage and was subject to periodic escalation. At the end of a fixed term, the royalty was subject to redetermination (either by agreement of the parties or through arbitration) based upon the market value of the gas. The lease agreements conveyed rights only to gas, not oil, and imposed strict drilling obligations upon the pipelines designed to ensure that the leases would be fully and promptly developed. In addition, many of the agreements included conventional favored nations clauses [10] and take-or-pay clauses.[11]

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[9] An ordinary royalty, commonly referred to as a base royalty, is the landowner's share of the profits of production, free of the expenses of production. This royalty is frequently set at one-eighth of production profits. An overriding royalty is an interest in oil and gas produced at the surface and is assessed above and beyond the base royalty. In general, overriding royalties do not exceed one-eighth of production, and smaller fractions are common. See H. Williams & C. Meyers, *Manual of Oil and Gas Terms* § 418, at 340 (1981). In the instant case, by contrast, the pipelines were required to pay a special overriding royalty on the entire net interest assigned to them by the producers (*i.e.*, the interest remaining after deduction of the base and conventional overriding royalties). The net interest assigned in GLA-47 was approximately 70%; in PLA-5 the net interest assigned was about 80%.

[10] The typical favored nations clause provided that the interest owner would receive the highest overriding royalty rate paid by the pipeline producer for gas production under any lease-sale agreement covering acreage located within 200 miles of the interest owner's acreage (Pet. App. 73a).

[11] Under a take-or-pay clause, the lessee is obligated to pay for a specified minimum volume of gas production from the acreage, regardless whether that volume is actually produced and taken into the pipeline (Pet. App. 51a n.40).

4. The instant controversy arose in 1973, when El Paso and Sun Oil Company (Sun) were unable to agree on a mutually acceptable royalty rate for one of the lease contracts. In the absence of agreement, the contract provided for determination of the royalty rate by a board of arbitrators, which was to base its decision on the current value of the gas at the wellhead (Pet. App. 40a).

At Sun's request, the dispute was submitted to the board, which agreed with Sun that the royalty should be based on the going wellhead price for natural gas in the higher priced intrastate market rather than the lower regulated rate for interstate sales of gas of the same vintage (Pet. App. 40a). Soon thereafter, other San Juan Basin producers demanded redetermination of the rates applicable to their overriding royalties, under either rate redetermination or favored nations clauses in their lease-sale agreements (*id.* at 40a-41a).

C. The Rulings of the District Court and the Commission

El Paso subsequently brought suit in the United States District Court for the Western District of Texas, arguing that the lease sales were subject to Commission jurisdiction under the Natural Gas Act and, therefore, that the arbitration award could not exceed the applicable Commission price ceiling. El Paso also filed a complaint with the Commission, seeking a determination that the lease-sale agreements were subject to the Commission's jurisdiction. Northwest intervened in both the district court and Commission proceedings and sought a declaration of jurisdiction with respect to its lease sales.

The district court and the Commission reached conflicting conclusions. The court held that the lease sales were not subject to Commission jurisdiction

(Pet. App. 121a-136a). The Commission, on the other hand, held that it had jurisdiction over the transactions under this Court's decision in *Rayne Field* (Pet. App. 21a-31a, adopting the decision of the administrative law judge, Pet. App. 33a-120a). The Commission based its ruling on what it perceived to be the economic and commercial realities of the lease-sale transactions, finding that here, as in *Rayne Field*, the lease sales were the economic equivalent of conventional wellhead sales because they accomplished the transfer of large volumes of proven natural gas reserves from producers to pipelines for resale in interstate commerce. In the Commission's view, these economic and commercial realities compelled the conclusion that the transactions were subject to regulation under the Natural Gas Act.

D. The Opinion of the Court of Appeals

The court of appeals reversed the Commission and affirmed the district court (Pet. App. 1a-19a). The court noted that, although the issue was "of substantial significance," it was "difficult to decide" because "[n]either the statute nor the cases give definitive direction" (*id.* at 11a). The court concluded, however, that the Commission had misconstrued *Rayne Field* by elevating "economic equivalency * * * from a component in the *Rayne Field* test to the determinative factor on the issue" (*id.* at 12a-13a). In the court's view, the Commission erred in not focusing sufficiently on the requirement that the reserves be "substantially developed" at the time of the lease sales to assure " 'imminent ability to produce in commercial quantities' " (*id.* at 15a, quoting *Continental Oil Co.* v. *FPC*, 370 F.2d 57, 64 (5th Cir. 1966), cert. denied, 388 U.S. 910 (1967)). The court explained (Pet. App. 15a):

> While the Commission's down-playing of the development issue may well foreshadow the next stage in the evolution of the law, for the time being our precedents demand full application of all components of the *Rayne Field* test, including the proven and substantial development factor * * *. We perceive the *Rayne Field* test to reflect the Supreme Court's concern with the apparent congressional intent not to regulate production. A purely economic test would seem to encroach on that concern.

The court of appeals acknowledged that "the reserves in the Basin may well have been 'proven' at least within reasonable estimates" (Pet. App. 15a). It concluded, however, that, "because the acreage was not substantially developed, the agreements in issue were not sales of gas under the Natural Gas Act" (Pet. App. 17a). The court acknowledged that an important factor on which it relied in reaching its decision was "the limited extent to which the Basin had been drilled at the time the [lease agreements] were executed" (*id.* at 15a).

REASONS FOR GRANTING THE PETITION

This case presents an important question concerning the scope of the Commission's jurisdiction under the Natural Gas Act. Although the court of appeals purported to apply settled precedent in deciding this jurisdictional issue, the effect of the court's ruling is to broaden the scope of the "production or gathering" exemption of Section 1(b) of the Act, 15 U.S.C. 717(b), beyond the intent of Congress as construed in the decisions of this Court. The decision below is at odds with the teachings of this Court in *Phillips* and *Rayne Field*, and is inconsistent with a number of other court of appeals decisions. If allowed to

stand, the decision below would preclude the Commission from effectively regulating the rates charged for gas produced from fields that are major sources of gas supply for the two major interstate pipelines that serve the western United States.[12] It would also have a significant financial impact on the pipelines and their customers. In these circumstances, review by this Court is warranted.

1. Prior to *Phillips*, the governing rule was that lease transfers were not subject to the Commission's jurisdiction under Section 1(b) of the Natural Gas Act. See *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949). Expressing the view that "leases are an essential part of production" (*id.* at 505), the Court in *Panhandle* concluded that "the transfer of undeveloped gas leases is an activity related to the production and gathering of natural gas and beyond the coverage of the Act" (*id.* at 515).

In *Phillips*, however, the Court rejected such a formalistic reading of the "production or gathering" exemption. The Court stated that " '[e]xemptions to the primary grant of jurisdiction in the section [1(b)] are to be strictly construed' " (347 U.S. at 679 (footnote omitted), quoting *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682, 690-691 (1947)).[13] As the Court viewed the legislative history of the Natural Gas Act, Congress intended "to give the

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[12] El Paso serves markets in Texas, New Mexico, Arizona, Nevada and California. Northwest serves markets in Colorado, Wyoming, Idaho, Oregon, Washington and Nevada.

[13] The Court noted, in this regard, that the relevant committee reports "reveal that a construction of the 'production or gathering' exemption which would substantially limit the affirmative grant of jurisdiction to the Commission was not contemplated" (347 U.S. at 679 n.7).

Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company" (347 U.S. at 682 (footnote omitted)). The Court noted that, because the rates charged by independent producers for these sales "may have a direct and substantial effect on the price paid by the ultimate consumers," its decision was consistent with the primary purpose of the Natural Gas Act, which was to protect consumers "against exploitation at the hands of natural-gas companies" (*id.* at 685).

The Court's reading of the congressional purpose in *Phillips* led it to change its analytical approach in determining the question of Commission jurisdiction over lease-sale agreements. This new approach was enunciated in *Rayne Field.* There, the parties had initially structured the transaction as a conventional wellhead sale, which clearly would have been considered jurisdictional under *Phillips.* However, after a decision in another case [14] indicated that the proposed rates would not be approved by the Commission, the parties recast the transaction in lease-sale form in the expectation that the transaction would be considered outside the Commission's jurisdiction under *Panhandle.* The Commission rejected this effort to escape its jurisdiction. In its view, to make the result turn on whether the transaction "was cast as a sale of leases instead of a sale of natural gas 'would exalt form over substance, would give greater weight to the technicalities of contract draftsmanship than to

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[14] *Public Service Commission* v. *FPC*, 257 F.2d 717 (3d Cir. 1958), aff'd *sub nom. Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378 (1959) (the "*Catco*" case).

the achievement of the purposes of the Natural Gas Act, and would impair [its] ability to control the price received for gas sold to the pipelines in interstate commerce to the detriment of the ultimate consumer' " (*Rayne Field*, 381 U.S. at 398, quoting *Texas Eastern Transmission Corp.*, 29 F.P.C. 249, 256 (1963)). The Fifth Circuit, however, relying on *Panhandle*, concluded that the leases "relate to the production or gathering of natural gas and are thus outside Commission jurisdiction" (*Marr* v. *FPC*, 336 F.2d 320, 325 (1964)).

This Court reversed, concluding that the lease sales could be considered "sales" of natural gas in interstate commerce for purposes of the Natural Gas Act. The Court explained (381 U.S. at 401 (citation omitted)):

> The sales of leases here involved were, in most respects, equivalent to conventional sales of natural gas which unquestionably would be subject to Commission jurisdiction under *Phillips* * * *. Indeed, the context of this case shows that when the first plan was aborted by the *Catco* case, the parties did not alter their objectives, but merely the method of attaining them. * * * There are differences, to be sure, between the original sale agreements and the lease-sale plan. * * * But it is perfectly clear that the sales of these leases in Rayne Field, a proven and substantially developed field, accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States. That is the significant and determinative economic fact. To ignore it would substantially undercut *Phillips*, and because of it the Commission * * * acted properly in treating these sales of leasehold in-

terests as sales of natural gas within the meaning of the Natural Gas Act.

The Court emphatically rejected the contention that the lease sales were outside Commission jurisdiction because of the "production or gathering" exemption. Instead, it concluded that "even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation" (381 U.S. at 402). The Court noted that if the "production or gathering" exemption were construed as turning "purely on a matter of the timing of the title transfer," that would mean that any sale of gas in place would fall within the exemption (*ibid.*). In the Court's view, "[a]cceptance of any such narrow interpretation would make *Phillips* a shadow" (*ibid.*).

The decision below erroneously limits *Rayne Field* to its specific facts while disregarding the central teaching of that case and *Phillips*—that all wholesales of gas in interstate commerce, whether cast in the form of conventional sales contracts or lease transactions, are jurisdictional. Thus, contrary to the view of the court of appeals (Pet. App. 14a-15a), in determining whether a transaction is subject to regulation under the Natural Gas Act, the controlling factor is not the form, but the economic and commercial substance of the transaction. To be sure, as this Court pointed out in *Rayne Field*, "substantiality of development is a relevant consideration, for the more that must be done before the gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce" (381 U.S. at 403). However, it is one thing to say, as this Court did in *Rayne Field*, that substantiality of development is *a*

relevant consideration; it is quite another to conclude, as did the court of appeals in this case, that substantiality of development is the sine qua non of Commission jurisdiction over lease-sale agreements. Indeed, if substantiality of development were an essential predicate to jurisdiction, it would have been wholly unnecessary for the Court in *Rayne Field* to have stressed that "even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation" (381 U.S. at 402), and that "the 'production or gathering' exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction" (*ibid.*).

To the extent that the court of appeals may have relied on this Court's decision in *Panhandle* to support the result below (see Pet. App. 15a), that reliance is completely misplaced. The Court in *Rayne Field* distinguished *Panhandle* on the ground that it "did not involve a sale of natural gas for resale in interstate commerce, but a transfer * * * for sale of the gas in *intra*state commerce" (381 U.S. at 403-404 (emphasis in original)). Although the Court noted that *Panhandle* was also distinguishable because it involved the transfer of undeveloped leaseholds (381 U.S. at 403), the Court expressly disapproved certain broad language in *Panhandle*, including the statement that " 'leases are an essential part of production' " (381 U.S. at 404 (quoting *Panhandle*, 337 U.S. at 505)). The Court emphasized that such flat statements "should not be taken to cover more than the particular kind of leases that were before the Court; it should not be considered as embracing each and every transfer that can be put in lease form" (381 U.S. at 404).

The court below also erroneously relied (Pet. App. 15a) on *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), cert. denied, 406 U.S. 976 (1972), which held that the typical lease agreement, granting the right to explore for gas on the lessor's property, is not subject to Commission jurisdiction. The court in *Mobil*, unlike the court of appeals in this case, recognized that *Phillips* and *Rayne Field* "were written with full awareness of the significance, in commercial and regulatory terms, of the sales of gas by independent producers to interstate pipeline companies" (463 F.2d at 261-262). Indeed, the court in *Mobil* pointed out that *Rayne Field* was grounded on the realization that "these lease transfers were the equivalent 'in economic effect to the concept of conventional sales' and such conclusion was required so as not to open gaps in Federal regulation" (463 F.2d at 262). The court emphasized that the jurisdictional foundation under the Natural Gas Act—"sales in interstate commerce"—was admitted in *Phillips* and "exist[ed] through economic equivalent in *Rayne Field*" (463 F.2d at 262). In contrast, "an ordinary lease by a landowner to a producer * * * is neither a 'customary' sale in interstate commerce nor its equivalent in economic effect" (*ibid.*). Unlike a lease-sale agreement involving proven reserves, as in this case and *Rayne Field*, a typical gas lease transfers "only the right to explore, develop, and market if exploration is successful; no royalty is paid if no gas is discovered" (463 F.2d at 262). Moreover, the landowner's royalty is generally payable on 12½% of production, not, as here (and in *Rayne Field*), on the entire net interest assigned, which amounts to between 70% and 80% of production. Thus, far from supporting the decision below, the *Mobil* case merely

serves to underscore the error of the court of appeals in rejecting the Commission's focus on commercial realities.[18]

2. The decision of the court of appeals cannot be reconciled with its own decision in *Continental Oil Co.* v. *FPC*, 370 F.2d 57 (5th Cir. 1966), cert. denied, 388 U.S. 910 (1967) (*Ship Shoal*), and is at odds with the decision of the Tenth Circuit in *Cities Service Gas Co.* v. *FPC*, 424 F.2d 411 (1969).

In *Ship Shoal*, the court (per Judge Wisdom) acknowledged that the leaseholds were "a 'long way' from being fully developed" (370 F.2d at 66). In fact, at the time of the lease-sale agreement, there was only one gas well, which was shut-in and had no production history, and it was calculated that at least 34 to 40 additional completions would be necessary

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[18] Furthermore, the court of appeals' holding that properties must be substantially developed at the time the lease agreements are signed overlooks the undisputed economic fact that producers generally will not commit capital to develop their properties until a market for the gas has been found and a long term gas purchase contract has been executed (see Pet. App. 110a). Thus, the court below plainly erred in examining the substantiality of development at the time the contracts were executed rather than at the time the gas properties were transferred. Since the jurisdictional inquiry under *Rayne Field* focuses on what was sold or transferred to the pipeline (*i.e.*, gas or something other than gas), and because Commission jurisdiction under the Natural Gas Act attaches only at the time of gas delivery and not at the time of execution of the sales contract (see, *e.g.*, *Tenneco Exploration, Ltd.* v. *FERC*, 649 F.2d 376, 379-380 (5th Cir. 1981)), the relevant date is clearly the transfer date. In this regard, the finding of the court below (Pet. App. 16a) that no wells had been drilled on the PLA-5 acreage at the time of the agreements is misleading; at the time of transfer, there were 75 wells on the acreage.

(*ibid.*). The court nevertheless held the lease sale to be jurisdictional, concluding that the gas field had "reached the stage of proof and development necessary to satisfy the *Rayne* criteria" (370 F.2d at 64). In reaching this result, the court pointed to (1) the pipeline's willingness to invest more than $97 million to connect its facilities with the underlying reserves; (2) the pipeline's reliance on those reserves to support its application to the Commission for authorization to construct the necessary facilities; (3) the Commission's approval of the pipeline's application; and (4) the pipeline's estimate that once production began it could extract a substantial percentage of the reserves during the first four years (370 F.2d at 65-66).

It is clear that the decision in *Ship Shoal* did not turn on the sort of mechanical well-counting approach engaged in by the court of appeals in this case. Rather, the court concluded (370 F.2d at 67):

> The crucial fact here, as in *Rayne*, is that the assignment of the leases accomplished the transfer of large amounts of substantially proven offshore natural gas reserves to an interstate pipeline company for eventual resale in interstate commerce. The transaction was a sale of a definable volume of gas, the price of which was geared to the actual volume found, and payment for which was directly related to its production —even if there has also been a transfer of an interest in real property. If such sales were not subject to Commission regulation, an "attractive gap" in the regulatory system would be created, and the producing states would be unable to close it.

Similarly, in *Cities Service*, the Tenth Circuit observed that the continuing validity of *Panhandle* was

"clouded" by *Rayne Field*, which the court construed as holding that the Commission "ha[s] jurisdiction over the sale of proven reserves to a pipeline" (424 F.2d at 416). See also *Louisiana Land & Exploration Co.* v. *FERC*, 574 F.2d 204, 207 (5th Cir. 1978), cert. denied, 439 U.S. 1127 (1979) ("economic realities * * * determine whether a jurisdictional sale has occurred").

3. Under the approach mandated by this Court in *Rayne Field*, the dispositive question is whether what was sold was gas or merely the right to explore for gas. In our view, the lease-sale agreements in this case clearly involved sales of natural gas in interstate commerce subject to the Commission's jurisdiction under the Natural Gas Act.

Here, as in *Ship Shoal*, the San Juan Basin reserves were relied on by El Paso to support a major expansion of its interstate pipeline facilities and by PNW to construct its entire interstate pipeline system. The Commission similarly relied on the reserves in certificating both construction requests. In its order granting El Paso's application for a certificate authorizing the expansion of its facilities shortly after the closing on GLA-47, the Commission removed a 34 Bcf annual ceiling on San Juan Basin volumes transported through the pipeline's system. *El Paso Natural Gas Co.*, 11 F.P.C. 1071, 1074 (1952). The Commission's action was wholly in accord with Delhi's own estimate that El Paso could produce 179 Bcf of gas, or 16.8% of the estimated recoverable reserves from GLA-47, in the first four years of production (R. 9692). By contrast, only 10% of the reserves involved in the transaction held jurisdictional in *Ship Shoal* were estimated as recoverable in the first four years (370 F.2d at 66). Fi-

nally, as soon as the pipelines' facilities were connected, substantial volumes of natural gas began to flow from these reserves into interestate commerce.

By rejecting the Commission's economic equivalency test in favor of its own mechanical well-counting approach, the court below has effectively rejected the teachings of *Phillips* and *Rayne Field* and has returned to the discredited approach of *Panhandle*. As a consequence of its erroneous approach, the court has reopened the regulatory gap that existed prior to enactment of the Natural Gas Act.

4. Unless overturned, the decision below would have a substantial adverse impact—both immediate and prospective—on the pipelines and on gas consumers in the western states, particularly California.

In 1974, following the Sun arbitration award (see page 8, *supra*), El Paso and Northwest entered into settlements with the producers in which the pipelines (while expressly reserving the right to litigate the jurisdictional issue) agreed to pay an overriding royalty based on the Commission's "new" gas ceiling rate even though most of the lease-sale gas was "old", lower-priced gas. As of June 1, 1983, for example, the ceiling rate for "new" gas under Section 102 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3312, was $3.421 per MMBtu, whereas the maximum lawful price for "old" gas under Section 104 of the NGPA, 15 U.S.C. 3314, ranged from 46.7 cents to 83.6 cents per MMBtu. See 48 Fed. Reg. 18795 (1983) (to be codified at 18 C.F.R. 271.101). Between 1974 and 1983, the overriding royalties paid by El Paso and Northwest to the producers were passed through by the pipelines to their customers and to the ultimate consumers under the cost-of-service approach. If the decision below is overturned and the Commission is held to have juris-

diction, the customers would be entitled to substantial refunds. Although refund estimates vary, the general consensus among the pipelines, their customers, interested state commissioners and the Commission staff is that such refunds would exceed $1 billion.

The future impact of the decision below is even more substantial. In *Public Service Commission* v. *Mid-Louisiana Gas Co.*, No. 81-1889 (June 28, 1983), this Court held that "first sales" of pipeline produced gas are subject to the price ceilings established in Title I of the NGPA. If the lease transactions are deemed to be nonjurisdictional, then under *Mid-Louisiana* the pipelines' sales of their production would be considered first sales within the meaning of the NGPA and the pipelines could charge their customers only the applicable NGPA rate rather than the cost-of-service rate (which takes into account the overriding royalty). The pipelines would still be required, however, to continue their royalty payments to the producers based on the NGPA's "new" gas ceiling rate, which is substantially higher than the applicable NGPA rate (see page 20, *supra*). As a result, the pipelines would suffer a loss of more than $2.00 per MMBtu for much of the gas they produce.[16] Of course, the pipelines could seek special rate relief from the Commission pursuant to Section 104(b)(2) of the NGPA, 15 U.S.C. 3314(b)(2), but that would simply shift liability back to the consumers. In this regard, the future financial impact of the decision below would likely outweigh the past impact, because

[16] Following the court of appeals' decision, El Paso determined that the GLA wells are unprofitable and attempted to reassign the wells to the producers under a provision in the GLA agreements. On February 15, 1984, a Texas court ruled that El Paso had no right to reassign the leases.

the lease-sale acreage remains a major source of supply for the two pipelines, containing estimated reserves of three trillion cubic feet of gas. If, on the other hand, the lease-sale transactions are held to be jurisdictional, then the pipelines would pay the producers an overriding royalty equal to the lower NGPA rate less the cost of production; the pipelines' customers, in turn, would pay the applicable NGPA price for the gas. In short, review by this Court is essential to ensure the effective protection of consumers from excessive charges.[17]

[17] It should be noted that the financial impact of this case far exceeds that in *Ashland Oil Co.* v. *Good*, No. 83-1234, *Mobil Oil Corp.* v. *Batchelder*, No. 83-1248 and *Cities Service Oil Co.* v. *Matzen*, No. 83-1278, which are pending before this Court on petitions for certiorari. In those cases, several natural gas producers entered into leases with landowners permitting them to explore for and produce natural gas on the leasehold acreage in return for royalty payments based on one-eighth of the "market value" of the gas. The gas produced from these fields was ultimately sold in interstate commerce and the producers paid royalties based upon applicable federal ceilings for "old" or "flowing" gas. The Supreme Court of Kansas held, however, that under the market value clause in the leases, the royalties should have been based on the higher price ceilings applicable to "new" gas. According to the producers in *Ashland*, the Kansas Supreme Court's decision would increase the royalties owed to the landowners to approximately 60% of the revenues received by the producers for sales of the gas. In contrast, the decision below would require the pipelines to pay royalties that are more than 400% greater than the price the pipelines could collect under the NGPA.

The Commission has filed an amicus brief in *Ashland* contending that the Kansas court's decision interferes with the Commission's implementation of the just and reasonable ratemaking scheme of the Natural Gas Act and thus is preempted by that Act. Here, as in *Ashland*, the impact of the lower court's decision collides with the primary purpose of the Nat-

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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ural Gas Act, *i.e.*, "[p]rotection of consumers against exploitation at the hands of natural-gas companies" (*Phillips*, 347 U.S. at 685). Unlike *Ashland*, however, this case involves activity that is directly subject to the Commission's regulatory authority.

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Nos. 83-1321, 83-1432, 83-1433,
83-1442, 83-1443 and 83-1618

In the Supreme Court of the United States

OCTOBER TERM, 1983

CALIFORNIA, ET AL., PETITIONERS

v.

TENNECO OIL COMPANY, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE FEDERAL ENERGY REGULATORY COMMISSION

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TABLE OF AUTHORITIES

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ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE FEDERAL ENERGY REGULATORY COMMISSION

This supplemental memorandum is filed in response to the Court's invitation to the parties to discuss the offer of settlement submitted to the Commission on May 18, 1984, by El Paso, Tenneco Oil Company and Conoco (hereinafter the Tenneco Oil settlement offer), as well as any other agreed—upon settlements that might have a bearing on the instant petitions for a writ of certiorari.

In the discussion that follows, we describe the principal provisions of the Tenneco Oil settlement offer. We also describe the pertinent provisions of two settlements that have been approved by the Commission and of one other pertinent application that is presently being contested in proceedings before the Commission. We emphasize at the

outset that the Commission takes no position at this time on whether the applications that are pending before it are in the public interest.

1. a. The Tenneco Oil settlement offer is the latest of four settlements entered into by parties to this case.[1] Two earlier settlements, one involving Northwest Pipeline and Phillips Petroleum, and the other involving Northwest and Getty Oil, have been approved by the Commission. *El Paso Natural Gas Co.*, 25 F.E.R.C. para. 61,292 (1983); *El Paso Natural Gas Co.*, 26 F.E.R.C. para. 61,421 (1984). The Commission found these two settlement agreements to be substantially identical (*id.* at 61,943). The settlements provide in pertinent part as follows:

> (1) Northwest is to pay Phillips and Getty overriding royalty payments based on the applicable NGPA ceiling prices (the "old" gas replacement contract rate, currently about 86¢ per MMBtu; this rate is subject to possible rollback to the flowing gas rate, currently about 47¢ per MMBtu) less Northwest's cost of production;
>
> (2) None of the processing plant liquids are to be credited to the producers, Phillips and Getty; and
>
> (3) In the event that the lease sales in question are found jurisdictional by the courts, Northwest would receive refunds back to September 25, 1980, of about $30 million from Phillips and about $2 million from Getty; Northwest would pass through these refunds to its customers.

The Commission emphasized that its approval of these uncontested settlements does not constitute a decision on the merits of any issue. Rather, the Commission reviewed

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[1] We are lodging with the Clerk of the Court copies of the pertinent applications to the Commission arising from these settlements.

the terms of the settlements in light of the court of appeals' decision in this case, and found the settlements to be fair, reasonable and in the public interest. 25 F.E.R.C. at 61,673-61,674.[2] Because these settlements expressly provide that any refunds from the producers to the pipeline (and ultimately to the customers) are contingent on a ruling that the lease sales are jurisdictional, it is clear that these Commission-approved settlements do not render moot the question of Commission jurisdiction presented in the instant petitions.

b. On November 11, 1983, Union Oil Company and El Paso entered into a settlement under which El Paso would reassign to Union the properties involved in the El Paso-Union GLA's. The reassignment is contingent upon Union's receiving a satisfactory certificate of public convenience and necessity from the Commission pursuant to Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c), authorizing it to sell gas produced from the subject properties. Thereafter, on December 13, 1983, Union filed with the Commission an application for such a certificate. A number of intervenors, including the Southern California Gas Company, the Pacific Gas and Electric Company and the State of California, objected to the application and requested an evidentiary hearing.

On May 10, 1984, the Commission set the matter for hearing before an administrative law judge.[3] That hearing has not yet commenced. In its order setting the matter for hearing, the Commission stated that, although the El Paso-

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[2]In approving the Northwest-Phillips settlement, the Commission stated (25 F.E.R.C. at 61,674):

> Critical in the balance is the uncertainty of the outcome of further court review of the former Fifth Circuit's decision concerning the Commission's jurisdiction over the GLA's and PLA's.

[3]We are lodging copies of the Commission's order with the Clerk of the Court.

Union settlement had not been submitted to it for approval, it is important for the Commission to ascertain the impact of the settlement on El Paso's customers in order to determine whether to grant Union's requested sales authorization (slip op. 4). The Commission therefore has required Union and El Paso to demonstrate that the settlement is in the public interest (*ibid.*).

The El Paso-Union settlement does not discuss the issue of refunds for past overpayments. Thus, if this Court were to grant certiorari and reverse the judgment of the court of appeals, the refund issue would remain to be addressed in the Commission's remedy proceeding, which was suspended after the court of appeals found the transactions nonjurisdictional.

The prospective effect of the El Paso-Union settlement may be summarized as follows:

(1) El Paso will reassign the properties to Union, which will sell the gas to El Paso under a conventional contract;

(2) Union will reserve for itself 25% of the gas it produces from newly drilled wells;

(3) Union's share of the net interest liquids under its properties will increase from 33-1/3% to 77% (and ultimately to 100% if Union elects to have the gas processed by a party other than El Paso);

(4) Union will charge El Paso several different prices for the gas, including the Section 109 rate for "old" gas (about $2.40 per MMBtu), on the theory that that gas was committed or dedicated to interstate commerce prior to enactment of the NGPA but was not subject to a just and reasonable rate set by the Commission;

(5) Union has the right to adopt the terms of any agreement entered into by El Paso with Tenneco Oil or Conoco.

The settlement also provided that Union could withdraw from the settlement if the Commission did not grant authorization for the sale of gas from Union to El Paso by April 1, 1984. Because the Commission has not yet granted such authorization, Union is free to withdraw from the settlement at any time.

c. The Tenneco Oil settlement offer was filed with the Commission on May 18, 1984. This settlement provides, in pertinent part, as follows:

(1) El Paso will reassign all of its GLA properties to Tenneco Oil and Conoco, which will sell the gas back to El Paso under conventional contracts;

(2) Tenneco Oil and Conoco will reserve for themselves 25% of the gas produced from post-1977 wells (about 50% of the gas comes from such wells);

(3) Tenneco Oil and Conoco will construct a new processing plant to extract more of the liquids from the gas stream (when the plant is completed, Tenneco Oil and Conoco will retain 100% of the liquids; until then, they will receive 77% of the liquids);

(4) Tenneco Oil and Conoco will sell the gas to El Paso at the applicable NGPA prices, except that "old" gas will be priced at $2.00 per MMBtu (plus NGPA monthly escalations) until July 1986, when it will be rolled back to the NGPA Section 106(a) rate (now about 88¢ per MMBtu);

(5) Tenneco Oil and Conoco will pay El Paso $50 million in refunds regardless of the outcome of the present litigation;

(6) The parties will amend a number of gas purchase contracts in the San Juan Basin to give the liquid rights to Tenneco Oil and Conoco; and

(7) Tenneco Oil and Conoco can withdraw from the settlement if it is not approved by August 1985 or within six months of a denial of certiorari; El Paso can withdraw from the settlement if it is not approved by August 1985 or within 30 days of a decision by this Court reversing the judgment of the court of appeals.

Because the ability of the parties to withdraw from the settlement is contingent upon this Court's disposition of the case, it seems clear that the mere filing of the offer of settlement with the Commission does not moot the jurisdictional issue presented in the instant petitions.

2. The procedures governing offers of settlement submitted to the Commission are set forth in Rule 602 of the Commission's Rules of Practice and Procedure, 18 C.F.R. 385.602.[4] Under this rule, uncontested offers of settlement, such as the Phillips and Getty settlements with Northwest, may be approved "upon a finding that the settlement appears to be fair and reasonable and in the public interest" (18 C.F.R. 385.602(g)(3)). Where an offer of settlement is contested, the Commission may decide the merits of the settlement "if the record contains substantial evidence upon which to base a reasoned decision or the Commission determines there is no genuine issue of material fact" (18 C.F.R. 385.602(h)).

Although, as discussed above, the Union settlement was submitted to the Commission in the form of an application by Union to sell the gas reassigned to it back to El Paso rather than in the form of an offer of settlement, it is evident from the Commission's order setting the matter for hearing

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[4]This rule is set forth at App., *infra*, 1a-5a.

that the Commission is treating Union's application as it would a contested settlement. The Tenneco Oil settlement offer was filed with the Commission on May 18, 1984, and comments thereon are not due until July 2, 1984. At this juncture, the Commission obviously is in no position to express any views concerning the merits of either settlement.[5]

Instead, we would note only that the Union and Tenneco Oil settlement offers are presently at early procedural stages before the Commission. It is likely that the Commission will not pass on the propriety of the settlements for a considerable period of time. In addition, if the Commission were to approve a contested settlement, its decision would be subject to judicial review by any aggrieved party.

3. In sum, the Commission's approval of certain settlements on the Northwest system has neither mooted the current litigation with respect to those parties nor made the case less worthy of this Court's consideration. Moreover, the settlements entered into by El Paso and three of the producers are subject to challenge by El Paso's customers, are likely to be pending before the Commission for some time, and if approved by the Commission would still be subject to judicial review. Accordingly, we adhere to the view expressed in our petition and reply memorandum that the overall ramifications of this case are sufficiently substantial to warrant review.

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[5]It would be particularly inappropriate for the Commission to comment on the merits of the settlement offers in light of the objections that have already been filed to Union's settlement, and in light of the recent submissions filed with this Court by the State of California, Pacific Gas and Electric and Northwest, which indicate that the Tenneco Oil settlement will most probably be contested.

It is therefore respectfully submitted that the petitions for a writ of certiorari should be granted.

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APPENDIX

§ 385.602 Submission of settlement offers (Rule 602).

(a) *Applicability*. This section applies to written offers of settlement filed in any proceeding pending before the Commission or set for hearing under Subpart E. For purposes of this section, the term "offer of settlement" includes any written proposal to modify an offer of settlement.

(b) *Submission of offer*. (1) Any participant in a proceeding may submit an offer of settlement at any time.

(2) An offer of settlement must be filed with the Secretary. The Secretary will transmit the offer to:

(i) The presiding officer, if the offer is filed after a hearing has been ordered under Subpart E of this part and before the presiding officer certifies the record to the Commission; or

(ii) The Commission.

(c) *Contents of offer*. (1) An offer of settlement must include:

(i) The settlement offer;

(ii) A separate explanatory statement;

(iii) Copies of, or references to, any document, testimony, or exhibit, including record citations if there is a record, and any other matters that the offerer considers relevant to the offer of settlement; and

(iv) A separate proposed Commission order approving the settlement, including the following statement: "The Commission's approval of this settlement does not constitute approval of, or precedent regarding, any principle or issue in this proceeding".

(2) If an offer of settlement pertains to a tariff or rate filing, the offer must include any proposed change in a form suitable for inclusion in the filed rate schedules or tariffs, and a number of copies sufficient to satisfy the filing requirements applicable to tariff or rate filings of the type at issue in the proceeding.

(d) *Service.* (1) A participant offering settlement under this section must serve a copy of the offer of settlement:

(i) On every participant in accordance with Rule 2010.

(ii) On any person required by the Commission's rules to be served with the pleading or tariff or rate schedule filing, with respect to which the proceeding was initiated.

(2) The participant serving the offer of settlement must notify any person or participant served under paragraph (d)(1) of this section of the date on which comments on the settlement are due under paragraph (f) of this section.

(e) *Use of non-approved offers of settlement as evidence.* An offer of settlement that is not approved by the Commission, and any comment on that offer, is not admissible in evidence against any participant who objects to its admission.

(2) Any discussion of the parties with respect to an offer of settlement that is not approved by the Commission is not subject to discovery or admissible in evidence.

(f) *Comments.* (1) A comment on an offer of settlement must be filed with the Secretary who will transmit the comment to the Commission, if the offer of settlement was transmitted to the Commission, or to the presiding officer in any other case.

(2) A comment on an offer of settlement may be filed not later than 20 days after the filing of the offer of settlement and reply comments may be filed not later than 30 days after

the filing of the offer, unless otherwise provided by the Commission or the presiding officer.

(3) Any failure to file a comment constitutes a waiver of all objections to the offer of settlement.

(g) *Uncontested offers of settlement.* (1) If comments on an offer are transmitted to the presiding officer and the presiding officer finds that the offer is not contested by any participant, the presiding officer will certify to the Commission the offer of settlement, a statement that the offer of settlement is uncontested, and any hearing record or pleadings which relate to the offer of settlement.

(2) If comments on an offer of settlement are transmitted to the Commission, the Commission will determine whether the offer is uncontested.

(3) An uncontested offer of settlement may be approved by the Commission upon a finding that the settlement appears to be fair and reasonable and in the public interest.

(h) *Contested offers of settlement.* (1)(i) If the Commission determines that any offer of settlement is contested in whole or in part, by any party, the Commission may decide the merits of the contested settlement issues, if the record contains substantial evidence upon which to base a reasoned decision or the Commission determines there is no genuine issue of material fact.

(ii) If the Commission finds that the record lacks substantial evidence or that the contested issues can not be severed from the offer of settlement, the Commission will:

(A) Establish procedures for the purpose of receiving additional evidence before a presiding officer upon which a decision on the contested issues may reasonably be based; or

(B) Take other action which the Commission determines to be appropriate.

(iii) If contested issues are severable, the uncontested portions may be severed and decided in accordance with paragraph (g) of this section.

(2)(i) If any comment on an offer of settlement is transmitted to the presiding officer and the presiding officer determines that the offer is contested, in whole or in part, by any participant, the presiding officer may certify all or part of the offer to the Commission. If any offer or part of an offer is contested by a party, the offer may be certified to the Commission only if paragraph (h)(2)(ii) or (iii) of this section applies.

(ii) Any offer of settlement or part of any offer may be certified to the Commission if the presiding officer determines that there is no genuine issue of material fact. Any certification by the presiding officer must contain the determination that there is no genuine issue of material fact and any hearing record or pleadings which relate to the offer or part of the offer being certified.

(iii) Any offer of settlement or part of any offer may be certified to the Commission, if:

(A) The parties concur on a motion for omission of the initial decision as provided in Rule 710;

(B) The presiding officer determines that the record contains substantial evidence from which the Commission may reach a reasoned decision on the merits of the contested issues; and

(C) The parties have an opportunity to avail themselves of their rights with respect to the presentation of evidence and cross-examination of opposing witnesses.

(iv) If any contested issues are severable, the uncontested portions of the settlement may be certified immediately by the presiding officer to the Commission for decision, as provided in paragraph (g) of this section.

(i) *Reservation of rights.* Any procedural right that a participant has in the absence of an offer of settlement is not affected by Commission disapproval, or approval subject to condition, of the uncontested portion of the offer of settlement.

Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443,
83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

EL PASO NATURAL GAS COMPANY,

PACIFIC GAS AND ELECTRIC COMPANY AND SOUTHERN CALIFORNIA GAS COMPANY

and

THE FEDERAL ENERGY REGULATORY COMMISSION,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

THE PUBLIC UTILITY COMMISSIONER OF OREGON, *et al.*

and

NORTHWEST PIPELINE CORPORATION, *et al.*,
Petitioners,

v.

PHILLIPS PETROLEUM COMPANY, *et al.*,
Respondents.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENTS TENNECO OIL COMPANY, *ET AL.*

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May 11, 1984

QUESTIONS PRESENTED

1. Whether the transfers of title to leasehold interests in the 1950's, where the underlying reserves did not meet the *Rayne Field* standard of "proven and substantially developed" so as to be "imminently capable of producing gas in commercial quantities," and the transfers were not the "economic equivalent" of sales of gas, constitute jurisdictional sales of natural gas.

2. Whether Section 2 (22) of the Natural Gas Policy Act of 1978 provides a new basis for reviewing transfers of title to leases after December, 1978, thereby rendering the decision of the Court of Appeals prospectively moot.

3. Whether the effect of this Court's decision in *Mid-Louisiana* renders the Court of Appeals decision prospectively moot.

PARENT COMPANIES, SUBSIDIARIES AND AFFILIATES OF RESPONDENT CORPORATIONS

Parent Companies, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Tenneco Oil Company:

Tenneco Corporation
Tenneco Inc.
Akulu Chemicals (PTY) Ltd.
Akulu Marchon (PTY) Ltd.
Albright & Wilson (Australia) Ltd.
Albright & Wilson Match Phosphorus Co. Ltd.
Arndale Fuels Ltd.
Bracey Petroleum Products Ltd.
Butler Oil Products Ltd.
Case Poclain GmbH & Co.
Collins Pipeline Company
Depositas Del Norte, S.A.
FC Marine Inc.
HT Gathering Company
Intertrac A.G.
Intertrac America Corporation
Intertrac G.B. Ltd.
Intertrac Italiana S.R.L.
Intertractor Viehmann GmbH & Co.
J.I. Case do Brasil & Cia.
Kern Island Water Company
Kern River Canal and Irrigating Company
Losenhausen Maschinenbau AG
Losenhausen Maschinenbau AG & Co.
Marchon-Paragon Holdings (PTY) Ltd.
Marchon-Paragon Sulphonation (Cape) (PTY) Ltd.
Marchon-Paragon Sulphonation (PTY) Ltd.
Meadows of the Kern Mutual Water Company
Mistal Inc.
Monroe Auto Pecas S.A.
Omni-Pac GmbH
P.P.M. Guindastes Hidraulicos S.A.
Poclain S.A.

Polyphosphates Inc.
S.A. Paper Chemicals (Proprietary), Limited
Sara Gretes Cafeteria AB
Skogstrea A/S
Societe Anonyme Industrielle de Resines
Stockdale Coffee Company
Stoco Mutual Water and Sewer Company
T & M Terminal Company
TENN-USS Chemicals Finance Corporation
Tees Storage Company Limited
Tenneco Oil Company of Nigeria Unlimited
Tenneco Property Corporation
Tenngasco Gas Gathering Company
Tractortechnic Canada, Ltd.
Universal Chemical Contractors (PTY)
Uplands of the Kern Mutual Water Company
Vibromax Australia (PTY) Ltd.
Vibromax France SARL
Vibromax SCI
W. R. John & Company (Rumney) Ltd.

Parent Company, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Conoco Inc.:

E.I. duPont de Nemours and Company
Cit-Con Oil Corporation
Conch International Methane Ltd. (Bahama Islands)
Conch L.N.G.
Conoco Exploration, Ltd.
Bishop Coal Company
Conrhein Coal Co. (Partnership)
Cardinal River Coals, Ltd. (Alberta, Canada)
Neptune Bulk Terminals (Canada) Ltd. (Canada)
Contochu Inc.
Harmar Coal Co.
Itmann Coal Co.
Tongue River Railroad (Partnership)
Oasis Oil Co. of Libya, Inc.

Colonial Pipeline Company
Dixie Pipeline Company
Explorer Pipeline Company
Lake Charles Pipe Line Company
Pioneer Pipe Line Company
Platte Pipe Line Company
Seadock, Inc.
Texas Offshore Port, Inc.
West Shore Pipe Line Company
Yellowstone Pipe Line Company
Kettleman North Dome Assoc.
Maritime Protection Inc.
Oil Shippers Service, Inc.
Petroleum Terminals, Inc.
Iricon Agency, Ltd.
Southern Facilities, Inc.
The Standard Shale Products Company

Parent Companies, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of American Petrofina Company of Texas:

American Petrofina, Incorporated
Petrofina Delaware, Incorporated
American Petrofina Exploration Company
American Petrofina Holding Company
Petrofina, S.A. (Belgium)
Cos-Mar, Incorporated
Mid-County Chemical Company
Fina Supply Inc.
American Petrofina Marketing Inc.

Parent Company, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Delta Drilling Company:

Perforadora Central, S.A. de C.V. (Mexico)
Grupo Constructor Central, S.A. de C.V. (Mexico)
Delta Marine Drilling Company

Tripart (I) Corp.
Tripart (II) Corp.
Tripart (III) Corp.
Tripart (IV) Corp.
Tripart (V) Corp.
Tripart (VI) Corp.

Parent Company, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Sun Exploration and Production Company:

Sun Company, Inc.
Alaska Bulk Carriers, Inc.
Hemisphere Oil Company, Inc. (Puerto Rico)
Mid-Valley Pipeline Company
Suncor, Inc. (Canada)
Lugrasa, S.A. (Panama)
Nuestro Publications, Inc.
Vessey Chemicals Pty. Ltd. (Australia)
Carboline GMBH
Carboline Coatings Ltd. (New Zealand)
Carboline Southeast Asia Ltd. (Singapore)
Taranaki Blast Services Ltd. (New Zealand)
Japan Carboline Company (Japan)
Carboline Europe (France)
Carboline S.A. de D.E.C.V. (Mexico)
Lavan Petroleum Company (Lapco) (Iran)
Japan Sun Oil Company, Ltd. (Japan)
Glacier Bay Transportation Corporation
Oil Insurance Limited (Bermuda)
Becton, Dickinson and Company
Canyon Reef Carriers, Inc.
East Texas Salt Water Disposal Company
Van Salt Water Disposal Company
Deepsea Ventures, Inc.
Explorer Pipeline Company
Texoma Pipeline Company
West Texas Gulf Pipeline Company

Sun Olin Chemical Company
International Biomedical Instruments, Inc.
VLM Corporation
Nova (an Alberta Corporation) (Alberta, Canada)
Nottingham Gas Limited (Saskatchewan, Canada)
Redwater Water Disposal Company Limited (Alberta, Canada)
Sultran Ltd. (Alberta, Canada)
Sun-Canadian Pipeline Company Limited (Ontario, Canada)
Solartech Limited (Canada)
Trilliun Exploration Corporation (Canada)
Sundata Corporation
Petromech Svn. Bhd. (Malaysia)
Sunoco de Chile Ltda. (Chile)
Venezoil C.A. (Venezuela)
White River Shale Oil Corporation
Tretol Ltd. (United Kingdom)

Parent Companies, Subsidiaries (Except Wholly-Owned Subsidiaries) and Affiliates of Atlantic Richfield Company:

[Listed in the separate "Brief in Opposition of the PLA Respondents" filed in these cases]

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443, 83-1618

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

THE PUBLIC UTILITY COMMISSIONER OF OREGON, *et al.*,
Petitioners,

v.

PHILLIPS PETROLEUM COMPANY, *et al.*,
Respondents.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENTS TENNECO OIL COMPANY, *ET AL.*

Respondents Tenneco Oil Company, *et al.*[1] respectfully suggest that this Court deny the petitions for a writ of certiorari

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[1] The Respondents joining in this Brief in Opposition are Tenneco Oil Company, Conoco Inc., American Petrofina Company of Texas, Crown Central Petroleum Corporation, Delta Drilling Company,

seeking review of the decision of the United States Court of Appeals for the Fifth Circuit in this case. That opinion is reported at 708 F.2d 1011.[2]

ADDITIONAL STATUTORY PROVISION INVOLVED

In addition to Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b) (1982), certain Petitioners have invoked Section 2(22) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301(22) (1982). That provision states as follows:

> DELIVER.—The term "deliver" when used with respect to any first sale of natural gas, means the physical delivery from the seller; except that in the case of the sale of proven reserves in place to any interstate pipeline, any intrastate pipeline, any local distribution company, or any user of such natural gas, such term means the transfer of title to such reserves.

STATEMENT OF THE CASE

Respondents are corporations, individuals, partnerships, trusts and estates who are royalty owners, not producers or sellers of natural gas. These cases were brought by El Paso Natural Gas Company ("El Paso") and Northwest Pipeline Corporation ("Northwest"), which are and have been the producers and sellers of gas under the agreements here at issue, in an effort to convert the royalty owners into jurisdictional sellers of natural gas.

In the early 1950's El Paso decided to build a pipeline to tap a new gas field. It acquired what the Federal Power Commis-

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Mr. and Mrs. Morris Mizel, Sun Exploration and Production Company, Atlantic Richfield Company, F.H.N., Ltd., W. Watson LaForce, Jr., *et al.* and Robert Beamon, Individually and as Trustee, Thomas L. Hail, Trustee and Pattie Ann Beamon Lundell (the "Beamon Parties").

[2] References in this Brief in Opposition to specific pages of the Court of Appeals decision and to specific pages of the other decisions below will be to the Appendix ("App.") filed with the Petition of The People of the State of California and The Public Utilities Commission of the State of California ("California") in No. 83-1321. References to the various petitions will be in the form "California Pet. at ____."

sion[3] described as "large, undeveloped acreage" from Delhi Oil Corporation.[4] *William G. Webb*, 49 F.P.C. 17, 18 (1973). Then and thereafter hundreds of thousands of acres of gas leases in the San Juan Basin area of New Mexico were acquired by El Paso, most of the leases with either a few wells or no wells drilled thereon. Since then, some 3,200 wells have been drilled by El Paso on the subject lease sale acreage.[5]

To acquire the leases so that El Paso could be the producer as well as the pipeline, it promised to pay a royalty to the former owners of the various leases, if gas were found pursuant to the drilling program to be conducted by El Paso. El Paso paid nothing for the leases; there was no purchase price based upon reserves in place, App. 127a, unlike *Rayne Field*,[6] *Bastian Bay*,[7] and *Ship Shoal*.[8]

El Paso presented the lease sale agreements to the Commission in both rate and certificate cases commencing in 1952.[9]

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[3] The Federal Power Commission and its statutory successor, Petitioner Federal Energy Regulatory Commission, will be referred to hereinafter as the "Commission."

[4] Delhi Oil Corporation is the predecessor-in-interest of Respondents Tenneco Oil Company and Conoco Inc. under the first and largest of the lease sale agreements at issue herein, commonly referred to by the parties as "GLA-47." *See* App. 9a.

[5] *See* "Proposed Findings of Fact and Conclusions of Law of El Paso Natural Gas Company" at 4, El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (Dist. Ct. Harris County, Texas, 11th Jud. Dist., filed March 21, 1984).

[6] United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965) ("Rayne Field").

[7] Pan American Petroleum Corp. v. FPC, 339 F.2d 694 (10th Cir. 1964), *rev'd*, 381 U.S. 762 (1965) ("Bastian Bay").

[8] Continental Oil Co. v. FPC, 370 F.2d 57 (5th Cir. 1966), *cert. denied*, 388 U.S. 910 (1967) ("Ship Shoal").

[9] Immediately after the closing of GLA-47, the President of El Paso explained the transaction in detail in sworn testimony before the Commission. R. 7991-8007.

Most of the agreements were never challenged by the Commission or any party. Those that were challenged were found by the Commission, in 1973, in a final order, to constitute genuine lease sales and not to constitute sales of gas under the *Rayne Field* doctrine. *Webb*, 49 F.P.C. at 26.[10]

For some twenty years El Paso operated the lease sale properties, drilled the wells, claimed all producer federal income tax benefits, paid the royalties and collected for itself a profit, or return, on the sales of gas to its customers, a profit being impermissible if the lease sales were a "sham" or *Rayne Field* transaction. As a pipeline producer, El Paso was permitted by the Commission to include the overriding royalties in the cost of service charged in the rates to its customers as costs "prudently incurred," and collected a return on investment, depreciation, and other charges that cannot be collected by the pipeline if the gas is purchased from independent producers.

The time came to increase the royalty payments, as agreed in the lease sale agreements.[11] El Paso resisted and, only nine months after succeeding before the Commission in arguing to the contrary, El Paso sued in federal court[12] to have Respondents declared sellers of gas under the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982), hoping to mitigate the royalty payments. The next year El Paso raised the same issue at the Commission, which declined to proceed until after the federal

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[10] El Paso argued in *Webb* that the lease sale agreements were *not Rayne Field* transactions. R. 17426-31.

[11] The agreements contained an arbitration clause that applied if the parties could not agree upon the amount of the redetermined overriding royalty. Pursuant to that clause, a Board of Arbitration set the overriding royalty for GLA-61, the lease sale agreement between El Paso and Sun Oil Company (Delaware), predecessor of Respondent Sun Exploration and Production Company. App. 129a.

[12] Section 22 of the Natural Gas Act, 15 U.S.C. § 717u (1982), confers exclusive jurisdiction over actions to enforce any duty created by the Natural Gas Act in the District Courts of the United States.

court had rendered its decision. *See El Paso Natural Gas Co.*, 55 F.P.C. 1677 (1976).[13]

El Paso settled the amount of the overriding royalty with the royalty owners, agreeing to pay the overriding royalty regardless of whether the Commission would authorize the inclusion of the royalty payments in its rates. R. 10403. Thereafter, in a separate case at the Commission, El Paso sought authority to charge its customers rates that included the higher overriding royalty payments.

The Commission had unquestioned jurisdiction to deny the recovery of the royalty payments in El Paso's rates. Yet in 1977 the Commission authorized El Paso to include the higher royalties in its rates, finding the royalty costs to have been prudently incurred and the resulting rate settlement between El Paso and its customers to be reasonable and proper and in the public interest. *El Paso Natural Gas Co.*, 57 F.P.C. 989, 998-1001, 1007-08 (1977). The customers of El Paso, including Petitioners here, supported this Commission Order and did not seek review of this or any subsequent order approving the inclusion of the royalties in El Paso's rates.[14]

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[13] In June, 1977, less than five months after the District Court entered judgment, the Commission instituted a proceeding on the same issue decided by the District Court: federal jurisdiction over the lease sale agreements. El Paso Natural Gas Co., 58 F.P.C. 2181 (1977). Respondents argued before the Court of Appeals on review of that Commission Order that the Commission had prejudged the case and that the doctrines of *res judicata* and collateral estoppel precluded the Commission from retrying the jurisdiction issue. The Court of Appeals allowed the Commission proceedings to go forward. Tenneco Oil Co. v. FERC, 580 F.2d 722 (5th Cir. 1978) (App. 137a-141a). Contrary to the argument of Petitioners Pacific Gas & Electric Company ("PG&E") and Southern California Gas Company ("So Cal Gas"), however, the Court of Appeals specifically held below that its decision to allow the Commission to proceed was *not* a reference of the case to the Commission under the doctrine of primary jurisdiction. App. 19a.

[14] *See* El Paso Natural Gas Co., Docket No. RP79-12 (Further Extension), *et al.*, Unreported Letter Order (August 28, 1983); El

The United States District Court for the Western District of Texas held that the lease sales were not jurisdictional sales of gas under *Rayne Field. El Paso Natural Gas Co.* v. *Sun Oil Co.*, 426 F. Supp. 963 (W.D. Tex. 1977) (App 121a-136a). The District Court found that the leases were not "proven," the leases were not "substantially developed," and the lease sales were not the "economic equivalent" of a gas sales contract. App. 131a-133a. Three years later, the Commission found the lease sale agreements to be jurisdictional sales of gas, holding that they were the "economic equivalent" of sales of gas. *El Paso Natural Gas Co.*, 12 F.E.R.C. (CCH) ¶ 61,297 (1980) (App. 21a-31a).

On review of both decisions, the United States Court of Appeals for the Fifth Circuit found that the lease sales were not subject to Commission jurisdiction, applying the standards of *Rayne Field. El Paso Natural Gas Co.* v. *Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983) (App. 1a-19a). The Court of Appeals reversed the Commission ruling, holding that the Commission misapplied the applicable law and that its decision was not supported by substantial evidence. App. 19a. The District Court's opinion was affirmed. *Id.*

For reasons that are not clear, some Petitioners take the position that the Court of Appeals determined that the leases were proven and that the lease sales were the economic equivalent of a gas sales contract. This is not correct. The District Court specifically found that the leasehold reserves were *not* proven and that the agreements were *not* the economic equivalent of sales of gas. App. 131a-133a. The Court of Appeals affirmed the District Court. App. 19a. All the Court of Appeals can be read to say is that reserves *in the San Juan Basin* "may

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Paso Natural Gas Co., 11 F.E.R.C. (CCH) ¶ 61,215 (1980); El Paso Natural Gas Co., 8 F.E.R.C. (CCH) ¶ 62,023 (1979); El Paso Natural Gas Co., Docket No. RP78-18, Unreported Letter Order (September 5, 1978); El Paso Natural Gas Co., 59 F.P.C. 1290 (1977); El Paso Natural Gas Co., 58 F.P.C. 1978 (1977).

well have been 'proven' at least within reasonable estimates," App. 15a, but only for purposes of demonstrating the inaccuracy of the application of the jurisdictional standard by the Commission. The Court of Appeals did not hold that the leasehold reserves themselves were proven. Indeed, the Court of Appeals specifically affirmed the District Court finding that "actual drilling is the only method of definitely locating recoverable gas saturations." App. 9a.[15]

Equally, the Court of Appeals did not find the lease sale transactions to be the economic equivalent of jurisdictional sales. Rather, the Court of Appeals found that the "economic" test applied by the Commission was so broad as to convert every lease transaction involving an interstate pipeline into a jurisdictional sale if it "ultimately results in successful production and disposition of gas in interstate commerce." App. 14a. The Court of Appeals properly rejected the Commission's formulation as an incorrect application of *Rayne Field. Id.*[16]

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[15] Overwhelming evidence supports the District Court's finding that the leasehold reserves were not "proven," whether or not reserves in the San Juan Basin generally were " 'proven' within reasonable estimates." App. 15a. Among the most compelling is a memorandum written by a vice-president of PG&E, one of the Petitioners herein, more than a month *after* the closing of GLA-47. In it, he noted that the reservoir engineering firm of DeGolyer and MacNaughton, which was retained by PG&E and So Cal Gas to make reserve estimates in the event the customers were called upon to finance El Paso's drilling program on the acreage, reported that while there appeared to be "plenty of gas in the Blanco area as a whole . . . further drilling will be necessary before the reserves can be classified as proven." R. 8728-29.

[16] Contrary to its position in this case, in *Webb*, the Commission *rejected* the argument that some of these same lease sale agreements were the economic equivalent of sales of gas. The Commission stated: "The transactions arose out of the needs of the parties rather than being almost wholly a rearrangement of payments, as in *Rayne*, to accomplish the same result as a conventional sale." 49 F.P.C. at 26.

No new principle of law was involved in the Court of Appeals decision. It was not a case of first impression, this Court having spoken. No issue of deference to some federal agency is raised here. The Court of Appeals provided judicial review to determine whether the law was correctly applied and whether there was substantial evidence to support the agency's findings. Where, as here, review involved application of the substantial evidence standard to the Commission's findings, this Court has held that the responsibility rests with the Court of Appeals. This Court intervenes only in the " 'rare instance when the standard appears to have been misapprehended or grossly misapplied.' " *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 309-310 (1974) (citation omitted).

The Commission now argues to delete the standard of "proven and substantially developed" from the *Rayne Field* test, claiming that the Court of Appeals decision creates a "gap" in the Commission's regulatory authority. FERC Pet. at 20. But the Commission applied and relied upon the "gap" of substantial development in a case just prior to this one in order to allow a pipeline to acquire leases without subjecting the lease seller to jurisdiction. *See Texas Gas Transmission Corp.*, 3 F.E.R.C. (CCH) ¶ 61,135 (1978) (discussed hereinafter at 13-14). Reliance upon this standard in one case and claiming that the standard creates a "gap" in another constitutes an administrative double standard.

At about the same time as the Court of Appeals decision below, this Court issued its decision in *Public Service Commission of New York* v. *Mid-Louisiana Gas Co.*, ___ U.S. ___, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983) ("*Mid-Louisiana*"). Commencing October 1, 1983, El Paso implemented the *Mid-Louisiana* decision by including in its rates certain prices under Title I of the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3333 (1982) ("NGPA"), for most of its pipeline production, including production from these leases. Based upon its implementation of *Mid-Louisiana*, El Paso now complains that it will have to absorb the overriding royalty payments to Respondents and incur a loss unless the Court of Appeals

decision is reversed.[17] Although El Paso complains that the impact of *Mid-Louisiana* upon its operation of these leases is a loss, El Paso's records indicate that it stands to gain billions of dollars in additional revenues based upon its implementation of that decision.[18]

As a consequence of El Paso's implementation of the *Mid-Louisiana* decision in its rate cases before the Commission, customer rates for El Paso's company-owned gas have increased and will remain at a higher level regardless of what happens to the Court of Appeals decision below. Both the Commission and El Paso concede that, for the future, the rates to El Paso's customers will remain the same, either way.[19]

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[17] On this basis, El Paso filed suit in a Texas State District Court claiming a contractual right under the lease sale agreements to reconvey the properties to the overriding royalty owners. El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (Dist. Ct. Harris County, Texas, 11th Jud. Dist., judgment entered Feb. 27, 1984). El Paso's attempted abandonment of these properties prompted California to contend in its Petition that the California customers would lose a supply of gas (California Pet. at 13-14), but the trial judge has entered judgment for the royalty owners, thereby preventing El Paso from alienating the leases. Significantly, El Paso's purported authority to reassign the leases was never called to the attention of the Commission in this case or in El Paso's rate cases.

[18] In this connection, El Paso claims that its exposure is great but cannot be quantified. El Paso Pet. at 11. This is strange. In evidence in *El Paso Natural Gas Co.* v. *Tenneco Oil Co., et al.*, No. 83-50539, is an exhibit (Tenneco/Conoco No. 208A) that is the official, in-house projection by El Paso. It states that El Paso stands to increase its revenues from its customers as a result of this Court's decision in the *Mid-Louisiana* case over the amount it was collecting on a cost of service basis by some $4.6 billion over the next twenty years. If, this report claims, El Paso has to continue to honor its royalty payments, it will nevertheless realize a net $3.8 billion in additional revenues out of the $4.6 billion increase in the rates that it will collect from its customers.

[19] *See* FERC Pet. at 21; El Paso Pet. at 10-11. The Commission *may* allow a rate increase pursuant to its authority to grant special

The Court of Appeals decision does not affect the Commission's authority to set El Paso's rates to its customers for gas from El Paso's own leases either for past or for future periods.[20] The Commission and those of El Paso's customers that are Petitioners herein should not be allowed to second guess their own past decision not to challenge the inclusion of these royalties in El Paso's rates, and indeed affirmatively to approve them as just and reasonable and prudently incurred.

For the future, this case does not determine whether the customers will bear these royalties. The question is whose *stockholders* (or, which individuals, partnerships, trusts and estates—also owners of these overriding royalties) enjoy the benefits of the monies attributable to these royalties: El Paso's or Respondents'.

Respondents respectfully submit that this is not a case warranting this Court's review.

REASONS WHY THE PETITIONS SHOULD BE DENIED

The basic issue decided by the Court of Appeals below was whether the lease sale agreements constitute *Rayne Field* transactions that are subject to Commission jurisdiction. The Court of Appeals properly found that they do not.

In *Rayne Field*, this Court determined that lease transactions are subject to Commission jurisdiction if the following questions all are answered in the affirmative:

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relief on the basis of increased royalty obligations. *See* FERC v. Pennzoil Producing Co., 439 U.S. 508 (1979). No such increase has been sought and, in any event, any application will be subject to judicial review. It is interesting to note that El Paso's chief company witnesses before the Texas State District Court in *El Paso Natural Gas Co.* v. *Tenneco Oil Co., et al.*, No. 83-50539, testified in December, 1983, and January, 1984, that special relief would not be granted to El Paso on the basis of these overriding royalties.

[20] El Paso's rates are regulated by the Commission under Section 4 and Section 5 of the Natural Gas Act, 15 U.S.C. §§ 717c, d (1982), and Section 601 of the NGPA, 15 U.S.C. § 3431 (1982).

1. Did the transaction involve the transfer of proven and substantially developed reserves?
2. Was the transaction the economic equivalent of a sale of gas?
3. Was the transfer to an interstate pipeline for the purpose of interstate transmission and sale?

See Rayne Field, 381 U.S. at 401; *Ship Shoal*, 370 F.2d at 62.

As to the test of "proven and substantially developed reserves," the Court of Appeals affirmed the District Court, which found that the reserves were neither proven nor substantially developed. App. 131a-133a. The Court of Appeals ruled:

> Specifically, we hold the reserves underlying the leaseholds were not substantially developed at the time the lease sales were executed because of the lack of "imminent ability to produce in commercial quantities." App. 15a (citation omitted).

As to the test of "economic equivalent of a sale of gas," the Court of Appeals affirmed the District Court, which found that the transactions were not the economic equivalent of sales of gas. App. 133a. The Court also held that the Commission's reliance upon an "economic equivalency" standard was erroneous. The Court of Appeals found that the Commission had "elevated the first prong [of the *Rayne Field* test]—economic equivalency—from a component in the *Rayne Field* test to the determinative factor on the issue." App. 12a-13a. The Court of Appeals continued:

> Carried to its logical conclusion, the Commission's economic equivalency/commercial realities approach could render any sale of lease rights to an interstate pipeline company jurisdictional merely because the transaction ultimately results in successful production and disposition of gas in interstate commerce. App. 14a.

To support their petitions filed in this Court, the Petitioners do not so much attack the underlying factual basis for the Court of Appeals decision as they rely upon an unprecedented modifi-

cation of the *Rayne Field* standard, as well as a mischaracterization of the Court of Appeals decision. The Petitioners' "Questions Presented" demonstrate these distortions.

First, some Petitioners' "Questions Presented" *ignore* the substantial development test that has been relied upon by the Commission and the courts as an essential element of the three-part jurisdictional standard.[21] The Questions do not even challenge the holding of the Court of Appeals that the lease sale reserves were not substantially developed.

Second, the "Questions Presented" erroneously assert that the Court of Appeals found the lease sale reserves to be "proven" and found the agreements to be the "economic equivalent" of sales of gas. As demonstrated, the Court of Appeals did not so find.

Contrary to the Petitioners' assertions, the Court of Appeals decision does not interfere with the Commission's authority to regulate the rates for sales of gas from these leases. For all periods prior to and after this Court's decision in *Mid-Louisiana*, the Commission has had the power to establish the rates for sales of this gas. Moreover, based upon the passage of the NGPA and the decision in *Mid-Louisiana*, Respondents respectfully submit that the Court of Appeals decision is prospectively moot.

1. The Court of Appeals Properly Applied the *Rayne Field* Standard

In *Rayne Field*, this Court ruled that "the significant and determinative economic fact" surrounding the lease sale agreement at issue was that it involved "a proven and substantially developed field" and "accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other states." 381 U.S. at 401. The lease sale in *Rayne Field* involved a definable volume of gas, such that it was *gas*,

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[21] Only the Petition of the Public Utility Commissioner of Oregon in No. 83-1432 even *mentions* the substantial development test in its "Question Presented."

rather than merely the right to explore for and develop potential gas reserves, that was transferred. In *Rayne Field*, 19 out of a possible 26 wells had been drilled on the subject acreage. *Id.* at 396 n. 3. Substantial development of the leasehold acreage permitted estimates of reserves to be the basis of the purchase price for the leases. This Court stated:

> The substantiality of development is a relevant consideration, for the more that must be done before the gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce which, as Phillips held, the Act has affirmatively placed within Commission jurisdiction. *Id.* at 403.

By focusing on the substantiality of development of the leasehold reserves, this Court established a logical standard for determining equivalence to a sale of gas. If substantial development of the underlying reserves does not exist at the time of the lease transfer, a sale of gas in place is impossible because a definable volume of gas is uncertain, and estimates of reserves cannot be relied upon by the parties to the transfer.[22]

The Commission now argues to ignore the *Rayne Field* requirement that the leases transferred be "proven and substantially developed," claiming that by relying on this standard the Court of Appeals has created a "gap" in the Commission's regulatory authority. FERC Pet. at 20. Yet the Commission relied upon the "gap" of substantial development in a case just prior to this one in order to allow a pipeline to acquire leases without subjecting the lease seller to jurisdiction.

In *Texas Gas Transmission Corp.*, 3 F.E.R.C. (CCH) ¶ 61,135 (1978), the Commission concluded that because only 14 out of the 50 wells drilled on the leasehold acreage had been

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[22] In *Rayne Field, Bastian Bay* and *Ship Shoal*, the interstate pipelines agreed to pay a lump sum for the leases based upon an agreed upon estimate of reserves. In *Ship Shoal*, for example, the pipeline agreed to pay $97 million based upon an agreed reserve estimate. *Ship Shoal*, 370 F.2d at 60. By contrast, El Paso paid nothing to the lease owners for the leases in the San Juan Basin. A lump sum payment for reserves would have been impossible due to the minimal drilling that had occurred on the vast lease acreage.

completed, and 50 more wells were to be drilled, the subject acreage was "essentially undeveloped" at the time the leases were transferred, and the transfer did not constitute a jurisdictional sale. The Commission stated:

> Since the Loe interests had not sufficiently developed the field to be able to conduct economically feasible wellhead arrangements, Loe could not have made a conventional wellhead sale to Memphis if the parties had so desired. Only 14 wells had been completed and only 10 of these were productive, it is indicated, and the remaining wells and intended wells were in different states of disrepair. *Clearly, these are essentially undeveloped reserves requiring further development for feasible production.* It is indicated that Memphis is presently engaged in a program to drill 10 new wells and to rework 20 old wells and drilling activity is already to a depth of more than 4,000 feet, or almost double the depth of the wells acquired from Loe. *Except for the small volume of actual production, all indications are that the subject reserves are essentially undeveloped.* Memphis did not acquire a known volume of developed reserves, and the purchase price was not tied to the level of any future production of the magnitude of reserves ultimately discovered. Accordingly, in our view, the sale of reserves by Loe to Memphis does not constitute a sale for resale in interstate commerce requiring a certificate under Section 7(c) of the Natural Gas Act. 3 F.E.R.C. at 61,405-406 (emphasis added).

As in *Texas Gas*, a "known volume of developed reserves" did not exist under the lease sale acreage transferred to El Paso. Unlike *Texas Gas*, however, in which "the purchase price was not tied to the level of any future production of the magnitude of reserves ultimately discovered," *id.*, the lease sale agreements herein did not even establish a purchase price for the leases. If anything, the inability to establish a purchase price demonstrates that the leases in this case were *less* developed than in *Texas Gas*. A question of fundamental fairness arises when the Commission chooses to apply the substantial development test when it wishes to approve a lease sale, as in *Texas Gas*, and to ignore it when, as in this case, it does not like the result.

Please compare the facts in the *Texas Gas* case with those before the Court of Appeals below. The largest and first of the El Paso acquisitions, GLA-47, the Delhi lease sale, had 15 wells drilled into the Mesa Verde formation on the date of execution and 16 on the date of closing. App. 66a. Full development of the 102,000 acres conveyed, under then-existing spacing requirements, would have required in excess of another 300 wells; full development under today's spacing requirements would have necessitated more than twice that number of wells.[23] Similarly, the largest and first of the Northwest lease acquisitions had *no* wells on the 188,000 acres on the date of execution. App. 16a. On the closing date, only 75 out of a possible 590 wells, under the existing spacing requirements, or approximately 1200 wells, under today's spacing requirements, had been drilled. App. 85a n.97.

These numbers, like the numbers in *Texas Gas*, are far different from those confronting this Court in *Rayne Field* and *Bastian Bay*, or the court of appeals in *Ship Shoal*. In *Rayne Field*, 19 out of a possible 26 wells had been drilled on the lease acreage. 381 U.S. at 396 n.3. In *Bastian Bay*, 32 of a possible 39 wells had been drilled on the twelve contiguous leases conveyed. R. 14126.[24] In the *Ship Shoal* case, 17 wells had been drilled at the time of the transaction on the single lease of approximately 3,000 acres. 370 F.2d at 59-60; R. 21841. By comparison, at the time GLA-47 was signed, only 24 total wells

[23] The Pictured Cliffs formation, the only other formation with wells drilled thereon, had 9 wells drilled both at the time of execution and at the time of closing of GLA-47. App. 66a. Under applicable spacing requirements (which are the same today as in 1952), more than 600 Pictured Cliffs wells were necessary for full development.

[24] *See also* the discussion of the *Bastian Bay* facts by the Court of Appeals in Pan American Petroleum Corp. v. FPC, 339 F.2d 694, 695 (10th Cir. 1964), *rev'd*, 381 U.S. 762 (1965).

had been drilled on over 102,000 acres, with only 20 of the 146 non-contiguous leases conveyed having even one well drilled thereon. R. 3957-4127.[25]

Please look at the map lodged with the Clerk by Respondents.[26] Each small square is one square mile. Each large square is six miles square. For perspective, maps of Rhode Island and the District of Columbia, drawn to scale, are superimposed. You will note that the leases (shaded in blue) transferred by GLA-47, the original Delhi lease sale, are not contiguous and, in fact, are scattered over an axis of about 56 miles by 26 miles. There is no way that a contention can be made that

[25] In their discussion of the "trilogy" of jurisdictional cases, Petitioners inject a prior transaction between El Paso and Delhi as a purported example of an earlier *Rayne Field* transaction between the parties. Petitioners would have this Court believe that the "Barker Dome" transaction was the predicate for and was similar to the lease sale agreements at issue herein. As a threshold matter, that transaction never has been joined in the instant case nor has it ever been found by the Commission or any court to constitute a *Rayne Field* transaction. Moreover, the Presiding Administrative Law Judge noted in his Initial Decision below that the Barker Dome transaction "is not involved in this proceeding, and is substantially different in content from the El Paso lease-sale contracts that were executed later." App. 56a. The Barker Dome transaction involved a geographical and geological area distinct from the area of the San Juan Basin covered by the lease sale agreements at issue herein.

The Barker Dome transaction did not, as Petitioners claim, represent an attempt to avoid Commission jurisdiction. The Administrative Law Judge's Initial Decision acknowledges (App. 46a-47a n. 29) that the concern expressed over Commission jurisdiction was in connection with an earlier agreement, later rescinded, that would have made Delhi a joint owner of El Paso's pipeline extending from the Barker Dome Field area. The pipeline affiliation was terminated long before the Barker Dome lease sale took place. The Commission adopted the finding of the Administrative Law Judge. App. 24a.

[26] The map is a copy of Exhibit 40-EP-1911 (GLA-47, Mesa Verde formation as of March 1, 1952) in the District Court and Commission proceedings below, R. 9972, with overlay added.

a well drilled can produce gas from leases up to 20 miles away. Indeed, the evidence shows that up to four wells per square mile are required to produce the gas from the Mesa Verde formation,[27] so one well cannot even produce the gas from one square mile. In the Pictured Cliffs formation, above the Mesa Verde, even fewer wells had been drilled.

The Court of Appeals properly noted that a comparison of the number of wells in place at the time of the lease sales' execution and the number of wells necessary to complete production from the lease sale acreage is relevant to the substantiality of development. App. 16a-17a. The more wells that must be drilled *after* the transfer of the leases, the less the acreage transferred is imminently capable of producing gas in commercial quantities, and, as this Court stated in *Rayne Field*, "the more that must be done before the gas begins its interstate journey." 381 U.S. at 403.[28]

Petitioners erroneously assert that the drilling undertaken by El Paso *after* the execution of the lease sale agreements indicates that the reserves were imminently producible in commercial quantities. Petitioners rely upon estimates made at the time GLA-47 was executed indicating that large volumes of gas could be delivered into El Paso's pipeline within a few years after execution. FERC Pet. at 19. These estimates cited by Petitioners were predicated upon drilling and development

[27] The Court of Appeals properly noted that in 1974, El Paso applied for and obtained permission from the New Mexico Oil Conservation Commission to increase to two the number of wells permitted to be drilled on a 320-acre unit in the Mesa Verde formation. App. 16a. The State Commission order was based in part upon testimony sponsored by El Paso that rapid depletion of the Mesa Verde formation was not possible under existing 320-acre spacing. R. 16664-16736.

[28] The Court of Appeals found that in 1976, 736 wells had been drilled on the GLA-47 acreage compared to the 24 wells that had been drilled at the time GLA-47 was executed in 1952. In 1977, 365 wells had been drilled on the acreage transferred to Northwest by Phillips Petroleum Company under PLA-5, compared to *none* at the time PLA-5 was executed in 1953. App. 15a-16a.

to be conducted by El Paso *after* it acquired the leases.[29] Indeed, the rigorous development program undertaken by El Paso after the transfer of the leases, ultimately resulting in more than 3,200 wells on the lease acreage, is a measure, more than anything, of the *absence* of development that existed on the lease sale acreage at the time the agreements were executed.

El Paso, Northwest and others argue that the jurisdictional standard must be modified to eliminate the requirement that the leases be "proven and substantially developed" in order to prevent producers and pipelines, like El Paso and Northwest, from entering into lease sales that violate the Natural Gas Act. While it may seem strange for the two pipelines to make this claim about their own transactions, it seems most unlikely that the Commission can sustain such a claim, since not only has the Commission so recently applied the test of "substantial development" in order to allow an interstate pipeline to acquire leases without subjecting the royalty owner to jurisdiction as a seller of gas, *see Texas Gas*, but the Commission has scrutinized these lease sale agreements on a constant and continuing basis since their inception in the 1950's.

If El Paso and the other petitioners were to succeed in persuading this Court to alter the jurisdictional standard retroactively, the result would be not the closing of a claimed "regulatory gap," but rather that any interstate pipeline that has ever acquired leases that were subsequently successfully developed would be in violation of the Natural Gas Act. A change in the standard would call into question all of the pipeline production now owned by interstate pipelines, having acquired leases that were not substantially developed. According to the latest summary of interstate pipelines' gas supply, almost fourteen percent of total domestic reserves is owned by

[29] The studies cited by the Petitioners indicating the volumes of gas believed to be producible from the GLA-47 acreage in four years required the drilling, *by El Paso*, of more than 250 wells. R. 9737-9746.

interstate pipelines.[30] As the Court of Appeals pointed out, under the Commission's economic equivalency test in this case, every lease sale to an interstate pipeline would be subjected to jurisdiction under the Natural Gas Act. App. 14a.

Contrary to the position it now takes, the Commission itself has found in two separate proceedings that at the time of these very lease sales, El Paso did not offer the owners of these leases adequate incentives to explore for gas and to develop and sell any reserves which might exist, under conventional sales contracts. *See William G. Webb*, 49 F.P.C. at 23, 25; *El Paso Natural Gas Co.*, 57 F.P.C. at 998. The Commission held that acquisitions of these leases "were the only means El Paso was able to attach additional dry gas reserves because the conventional gas purchase agreements failed to provide adequate incentives to the producer." *El Paso Natural Gas Co.*, 57 F.P.C. at 998.

Some Petitioners claim that El Paso was *forced* to accept these lease sales in the 1950's because of the market power of the Respondents. California Pet. at 5; El Paso Pet. at 5. This is ridiculous. Since the early 1950's, El Paso has been the largest purchaser *and* the largest producer of gas in the San Juan Basin of New Mexico. When another pipeline company moved into the Basin and began to compete for gas leases and contracts and threatened El Paso's monopoly on the California market, El Paso bought out this competitor and further reduced competition, in violation of the antitrust laws. *See U.S. v. El Paso Natural Gas Co.*, 376 U.S. 651 (1964).[31]

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[30] Energy Information Administration, Department of Energy, Gas Supplies of Interstate Natural Gas Pipeline Companies, 1982, at 12, Table 3 (October, 1983).

[31] After a divestiture that was ordered by this Court (*see* U.S. v. El Paso Natural Gas Co., 376 U.S. at 662; U.S. v. El Paso Natural Gas Co., 358 F. Supp. 820 (D. Colo. 1972), *aff'd*, 410 U.S. 962 (1973)), the other pipeline is now known as Northwest Pipeline Corporation, a Petitioner in this proceeding.

2. The Court of Appeals Decision Does Not Expand the "Production or Gathering" Exemption of Section 1(b) of the Natural Gas Act.

Contrary to the Petitioners' claims, the Court of Appeals decision below does not expand the "production or gathering" exemption of Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b) (1982). Rather, the decision below recognizes that lease agreements such as these, by which undeveloped leases are transferred, precede even the production and gathering of natural gas. Because the reserves underlying the subject leases were undeveloped at the time of the lease sales, no "wholesale" of gas within the meaning of *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 682 (1954), was possible.

By arguing that the "production or gathering" exemption no longer exists with respect to undeveloped leases transferred to interstate pipelines, the Commission contradicts *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949) ("*Panhandle*"), in which this Court held that the "transfer of undeveloped gas leases is an activity related to the production and gathering of natural gas and beyond the coverage of the Act. . . ." 337 U.S. at 515. Accepting the Commission's argument would also resurrect the Commission determination, *rejected* by the court of appeals in *Mobil Oil Corp.* v. *FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972), that all lease sale agreements are jurisdictional sales of gas subject to Commission jurisdiction if the gas ultimately is sold in interstate commerce for resale. 463 F.2d at 258-59, 263.

The Petitioners' arguments improperly minimize the distinction drawn by this Court between *Rayne Field* and *Panhandle*, in which this Court ruled that the transfer of undeveloped leases from an interstate pipeline to an intrastate pipeline affiliate was not within Commission jurisdiction. The Court of Appeals properly noted: "[t]he Supreme Court emphasized the difference in the degree in development in explaining why it held the transactions jurisdictional in *Rayne*

Field, but nonjurisdictional in *Panhandle*." App. 15a (citation omitted).[32]

In this case, due to the minimal amount of drilling that had been conducted on only a few of the transferred leases, most of which had no wells at all, sales of commercial quantities of gas (indeed, even production and gathering of gas) was not possible upon the transfers except in small amounts on a few of the leases.[33] The terms of the lease sale agreements reflect these conditions.[34] In *Mobil*, the court noted that a gas lease "transfers only the right to explore, develop, and market if exploration is successful . . . ." 463 F.2d at 262.[35] In this case, where all

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[32] In *Rayne Field* this Court stated: "To recognize no differences between the Panhandle transfers and those in issue here . . . would turn the case-by-case process against itself." 381 U.S. at 404.

[33] Petitioners argue that the Court of Appeals' focus on the absence of substantial development overlooks the "undisputed economic fact" that a producer will not commence development of his leasehold acreage until he has obtained a market for his gas and a gas sales contract has been secured. FERC Pet. at 17 n.15. Yet in *Texas Gas*, the Commission *relied* on the fact that insufficient development had occurred on the leasehold acreage in order "to conduct economically feasible wellhead arrangements." The Commission stated that the lessor "could not have made a conventional wellhead sale . . . if the parties had so desired." 3 F.E.R.C. at 61,405-406.

[34] The terms of the agreements imposed drilling obligations upon El Paso and provided for payment of overriding royalties based only upon the gas produced. If no gas was produced, no royalties were due. Indeed, as the District Court found, the agreements provided that if drilling by El Paso indicated that acreage would not be productive of gas in commercial quantities, El Paso promptly could turn the lease acreage back. App. 126a, 132a.

[35] The court held in *Mobil* that a royalty interest retained by the lessor is not sufficient to make him a seller of gas. The court stated: "an economic interest in the proceeds of a sale, unaccompanied by authority to determine the incidents of the sale, does not make one a seller." 463 F.2d at 262. In this case, like *Mobil*, the only economic interest retained by the lease owners under the agreements was an overriding royalty. Unlike Louisiana Land & Exploration Co. v.

drilling and development was undertaken by El Paso, what was transferred was, as in *Mobil*, the right to explore for gas, *not* gas itself.

3. The Court of Appeals Decision Neither Affects the Commission's Authority To Regulate the Rates Charged Consumers for Natural Gas Nor Jeopardizes Gas Supply, as California Contends

Petitioners claim that unless the Court of Appeals decision is overturned, the Commission will be precluded from regulating the rates for natural gas charged to consumers in several western states. FERC Pet. at 10-11. This claim ignores the regulatory framework under the Natural Gas Act, under which the gas produced and sold by El Paso, "pipeline-owned" production, was regulated even *before* the *Phillips* decision and has been regulated continuously since. The Commission *always* has had jurisdiction over the rates charged by El Paso to its customers for gas from its own leases; nothing decided by the Court of Appeals operates to change in any manner this fact.

a. Prior to *Mid-Louisiana*, the Commission permitted El Paso to include the overriding royalties in its rates, and as recently as 1977 determined that El Paso was "prudent" in acquiring the leases in order to obtain a needed gas supply in the San Juan Basin. *El Paso Natural Gas Co.*, 57 F.P.C. at 998. In fact, the Commission commended El Paso in its 1977 order for the "degree of innovation and imagination" demonstrated in entering into the original agreements and the 1974 settlement agreements. *Id.* El Paso's customers did not challenge the continuing inclusion of the overriding royalties in any El Paso rate case, to and including September 30, 1983, although they had a right and an opportunity to do so.[26]

FERC, 574 F.2d 204 (5th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979), relied upon by Petitioners, in which the lessors retained control over the identity of the purchaser of the lessee's gas, in this case all control over the incidents of any sales of gas produced from the lease sale acreage was transferred to El Paso.

[26] *See* n. 14, *supra*.

Consistent approval of El Paso's rates illustrates how hollow is the claim that "the decision of the Court of Appeals has deprived consumers in the western states, especially California," of the protection of the Natural Gas Act. California Pet. at 13. Nothing in the Court of Appeals decision requires that the California customers or any customers of El Paso pay one cent of the overriding royalties. Payment of the overriding royalties is an obligation of the corporate shareholders of El Paso, and any charge for the overriding royalties in El Paso's rates is a separate matter entrusted to the Commission through its rate making jurisdiction.

With respect to potential refunds for past periods in the event the lease sale agreements are found to be jurisdictional sales of gas, each of the petitions claims, more or less, that the Court of Appeals decision has deprived the pipelines' customers of hundreds of millions, even a billion dollars in refunds. *See, e.g.*, FERC Pet. at 21. These claims have no basis in any decision by the Commission. When the Commission issued its order determining that the lease sales were subject to Commission jurisdiction, it ordered that proceedings be commenced to determine a remedy. The Commission stated:

> The basic issues to be addressed on remand are (1) whether and if so to what extent were the payments made by [the pipelines] to the overriding royalty owners excessive and therefore unlawful; (2) what *if any* amounts should be required to be refunded . . .; and (3) what level of royalties should be approved for the future? App. 30a (emphasis added).

The remedy issue never has been tried. No determination has been made, in any forum, that payments to the overriding royalty owners were excessive or that any refunds will be paid.

It is somewhat disingenuous for Petitioners to argue now that the Court of Appeals decision in 1983 deprived El Paso's customers of the benefits of the Natural Gas Act. It is also somewhat strained for the Commission to suggest that the royalty rate is too high, since the royalties agreed upon by El Paso at arm's length in the 1974 settlement agreements were, in the Commission's own words, "just and reasonable." *El Paso Natural Gas Co.*, 58 F.P.C. 2181, 2184 (1977).

The petitions by some of the customers of El Paso, specifically PG&E and So Cal Gas, also leave a certain candor behind. While PG&E and So Cal Gas assert that the royalty rate approved by the Commission (without objection) has burdened their customers (PG&E, So Cal Gas Pet. at 14), they do not inform this Court that they have been purchasing interstate gas from *their own affiliates* in preference to El Paso's gas even though El Paso's gas has been their cheapest source of interstate gas, even with the small component for the overriding royalties. The Commission now is investigating this situation in *Pacific Gas Transmission Company*, Docket Nos. RP83-113-000, *et al.* (Order denying rehearing of order consolidating proceedings entered April 2, 1984). At issue are the "minimum bills" of the interstate pipelines, including El Paso, Transwestern Pipeline Company and affiliates of PG&E and So Cal Gas. In that consolidated docket, on March 2, 1984, El Paso itself said:

> The fact that minimum bill/minimum take provisions of interstate pipelines serving the California market have caused untenable and unnecessary costs and burdens to be borne by California consumers is beyond dispute in these proceedings. Also beyond dispute is the fact that, because of such provisions, the loss of load in the California market has been borne almost entirely by El Paso despite El Paso's being the lowest cost out-of-state supplier to that market.[37]

b. Petitioners fail to inform this Court that under its implementation of the *Mid-Louisiana* decision, El Paso stands to increase its revenues from its customers, including its California customers, for pipeline production, which includes the leases involved in this suit, by more than $4.6 billion over the next twenty years. By El Paso's own estimate, if El Paso does not convert these lease sale agreements into jurisdictional sales of gas, El Paso still will realize more than $3.8 billion out of the over $4.6 billion in additional revenues that it will collect from its customers under its implementation of *Mid-*

[37] Pacific Gas Transmission Company, *et al.*, Docket Nos. RP83-113-000, *et al.*, "Motion by El Paso Natural Gas Company for Interim Initial Decision" at 17 (filed March 2, 1984).

Louisiana.[38] In any event, according to El Paso and the Commission, the California consumer will pay the same rate for gas after October 1, 1983, albeit a much higher rate, regardless of the outcome of the instant proceeding. El Paso Pet. at 10-11; FERC Pet. at 21.

A claim is made by California that the Court of Appeals somehow has forced El Paso to attempt to reassign the gas leases to the royalty owners in the Texas State District Court proceedings, thereby risking a loss of supply to the California customers. California Pet. at 13-14. Yet it was the corporate decision of El Paso, in order to maximize its profit potential under the *Mid-Louisiana* decision—not the decision of the Court of Appeals below—that led El Paso to attempt to reassign the leases to the royalty owners. The royalty owners undertook to defeat El Paso's attempt to reassign the leases, an effort they have in common with the California consumers. The State District Court Judge entered a judgment on February 27, 1984, holding that El Paso could not reassign the leases. As a consequence, the concern expressed by California pertaining to the potential loss of gas supply presently is moot.

4. Suggestion Of Prospective Mootness

Respondents respectfully suggest that the decision of the Court of Appeals now is prospectively moot due to: (a) the decision of this Court in *Mid-Louisiana*; and (b) the passage of the NGPA.

a. As a result of this Court's decision in *Mid-Louisiana*, any leases acquired presently or in the future by pipelines for the pipeline itself to develop and produce the gas for sale will be subject to the same regulation as gas sales from independent producer-owned leases. Thus, the decision of the Court of Appeals will have no effect on the customers of interstate pipelines, because the rate charged by the producer—be it an

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[38] *See* Tenneco/Conoco Exhibit 208A admitted into evidence in *El Paso Natural Gas Co.* v. *Tenneco Oil Co., et al.*, No. 83-50539.

independent producer or a pipeline producer—will be subject to the same regulatory constraints. Therefore, the decision of the Court of Appeals is prospectively moot from the effective date of the *Mid-Louisiana* decision.

Furthermore, the Commission asserts that the rates to El Paso's customers resulting from the implementation of the *Mid-Louisiana* decision will remain the same whether the Court of Appeals is affirmed or reversed. FERC Pet. at 21. No better demonstration of prospective mootness is possible.

b. The Commission argued below, but did not bring to this Court's attention in its petition, that the NGPA added the transfer of title to proven reserves to the definition of "first sales" to be subject to the price controls of the NGPA. This is Section 2(22) of the NGPA, 15 U.S.C. § 3301(22) (1982), which provides:

> DELIVER.—The term "deliver" when used with respect to any first sale of natural gas, means the physical delivery from the seller; except that in the case of the sale of proven reserves in place to any interstate pipeline, any intrastate pipeline, any local distribution company, or any user of such natural gas, such term means the transfer of title to such reserves.

Any lease transfers that occur after the effective date of the NGPA, December 1, 1978, are subject to review under this new Act, and the pricing provisions of any sales will be governed by the NGPA. In this circumstance, it will not matter whether the lease sale is or is not subject to the Commission's jurisdiction under the Natural Gas Act, and thus the Court of Appeals decision will have no precedential effect.[39]

5. Pending Issues Not Resolved by the Court of Appeals

Other significant issues were raised and argued below but were not reached by the Court of Appeals in the light of its

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[39] El Paso argues that the passage of this Section somehow indicates that the *Rayne Field* standards of "proven and substantially developed" and "economic equivalency" were no longer operative in 1978. El Paso Pet. at 22-23. This is gainsaid by the fact that in 1978 the Commission applied these very standards in the *Texas Gas* case.

disposition of the case. Thus, these issues are not now before this Court. The Court of Appeals summarized the points as follows:

> (1) since the district court decision preceded the Commission's decision, did it have a *res judicata* effect that bound the Commission? (2) having litigated and lost in the district court, were El Paso and Northwest collaterally estopped from claiming before the Commission that the transactions are jurisdictional? (3) was the Commission bound to treat the transactions as nonjurisdictional because of its prior rulings in connection with such transfers involving some of the same parties and the same basic facts? and (4) should the district court have referred the jurisdictional issue to the Commission under the doctrine of primary jurisdiction? Other subissues argued but not decided are: (a) whether the Commission prejudged the issues, (b) whether the petitions for review in No. 77-2613 concerning the Commission's decision to conduct a show-cause proceeding on the jurisdictional issue should be dismissed for seeking review of nonfinal interlocutory orders, and (c) whether the Commission's resolution of the jurisdictional question should be given only advisory effect in the court of appeals. App. 8a-9a.

CONCLUSION

Petitioners ask this Court to review a finding by the Court of Appeals that the Commission's order was not supported by substantial evidence or, in the alternative, Petitioners seek a retroactive change in the jurisdictional standard established by this Court in *Rayne Field*. Petitioners do not even raise the issue whether the Court of Appeals correctly affirmed the District Court, which held that the leases were not proven, not substantially developed, and that the lease sale agreements were not the economic equivalent of a gas sales contract. Equally, this Court's attention is not directed to the issues not reached by the Court below. El Paso, at least, concedes that even upon a reversal a remand would be required. El Paso Pet. at 25.

For some reason, the Commission did not call this Court's attention, as it did in the Court of Appeals below, to the fact that the NGPA provides a new statutory standard for review-

ing lease sales occurring after November, 1978. Respondents suggest that Section 2 (22) of the NGPA renders the Court of Appeals decision prospectively moot.

So also does the decision of this Court in *Mid-Louisiana* render the Court of Appeals decision prospectively moot. If, as the Commission argues, the rate for sales of gas from pipeline production is now the same as the rate for sales of gas from independent producers, the decision of the Court of Appeals has no effect on the rates charged by El Paso for production from the lease sale properties.

That leaves only a retroactive change, a change that would call into question the jurisdictional status of all leases previously transferred to interstate pipelines, which now constitute some fourteen percent of total gas supply in the United States. Since the Commission itself consistently applied the standards of "proven and substantial development" and "economic equivalency" in 1978 in order to allow a pipeline to acquire leases without subjecting the lease seller to jurisdiction (*Texas Gas*), it is difficult to sustain a claim of a new "regulatory gap." This is particularly true when the principal lease sales involved in this case took place thirty years ago, even before the *Phillips* decision.

No new principle of law is involved here. The Court of Appeals decision only involves application of the test established by this Court in *Rayne Field* to the facts of this case. The Commission, and the Petitioners allied with El Paso in its effort to be relieved of its contractual obligations, decided to allow El Paso to collect the royalties, which the Commission said were "just and reasonable," in its rates. *See El Paso Natural Gas Co.*, 58 F.P.C. at 2184. This decision by the Commission and El Paso's customers passed up this opportunity to reduce their gas costs, should Respondents prevail in this proceeding. That the agreed upon overriding royalties have been included in El Paso's past rates has no bearing on the question whether these leases transferred in the 1950's met the *Rayne Field* test.

Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443, 83-1618

IN THE
Supreme Court of the United States
OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,
v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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SUPPLEMENTAL MEMORANDUM OF RESPONDENTS TENNECO OIL COMPANY AND CONOCO INC.

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June 13, 1984

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TABLE OF AUTHORITIES

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

Nos. 83-1321, 83-1432, 83-1433,
83-1442, 83-1443, 83-1618

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

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SUPPLEMENTAL MEMORANDUM OF RESPONDENTS TENNECO OIL COMPANY AND CONOCO INC.

Respondents Tenneco Oil Company ("Tenneco Oil") and Conoco Inc. ("Conoco") respectfully respond to the Court's direction contained in the letter of the Honorable Alexander L. Stevas of May 31, 1984, calling for comment on settlement agreements "which might have a bearing upon pending petitions for writs of certiorari."

The offer of settlement filed at the Federal Energy Regulatory Commission ("Commission") by Petitioner El Paso Natural Gas Company ("El Paso"), Tenneco Oil

and Conoco would constitute a full and final settlement of all proceedings involving the lease agreements covering nearly seventy percent (70%) of the volumes of gas produced by El Paso that is involved in these petitions, if approved by the Commission and other responsible governmental agencies. *See* "Joint Supplemental Brief of Petitioner El Paso Natural Gas Company and Respondents Tenneco Oil Company and Conoco Inc.," filed May 30, 1984. Because all issues would not be resolved until there is Commission approval, which would also be subject to judicial review, Tenneco Oil and Conoco are of the view that *Havens Realty Corp. v. Coleman*, 455 U.S. 363 (1982), and *Nixon v. Fitzgerald*, 457 U.S. 731 (1982), are controlling.

Some elements of the settlement, reviewed below, are not dependent upon prior regulatory approval.

Tenneco Oil and Conoco have an option to accept reconveyance of the leases. If this option is exercised, some issues would be affected. Prospectively from the date of the exercise of the option, Tenneco Oil and Conoco would cease being royalty owners and would become producers of gas subject to the Commission's jurisdiction under the Natural Gas Act, 15 U.S.C. §§ 717-717w (1982), or otherwise subject to the pricing and other provisions of the Natural Gas Policy Act, 15 U.S.C. §§ 3301-3432 (1982). Tenneco Oil and Conoco would then supplant El Paso as owners of the leases and would assume the right to drill new wells. The exercise of this option to accept reconveyance is not contingent upon prior approval by the Commission.

Tenneco Oil and Conoco have agreed to keep the royalty rate at the current level until the Commission has had the opportunity to act on the settlement. That level of royalty has been stipulated by El Paso, Petitioner California Public Utilities Commission, and El Paso's customers, including Petitioners Pacific Gas & Electric Company and Southern California Gas Company, to be just and

reasonable and in the public interest for inclusion in El Paso's rates in the settlement of its latest general rate case. That stipulation of settlement was approved by the Commission as in the public interest and as a reasonable resolution of the issues pending in that case. *El Paso Natural Gas Co.*, 23 F.E.R.C. (CCH) ¶ 61,365 (1983).

Upon approval by the Commission and other responsible governmental agencies, Tenneco Oil and Conoco would be obligated to exercise the option to accept reconveyance of the leases and would be obligated to fulfill any other terms of the settlement agreement, which includes the payment of $50 million in refunds to El Paso's customers. Tenneco Oil and Conoco have identified approximately 1,100 gross well sites that appear to warrant development if the settlement is approved.

The settlement survives denial of the petitions for writs of certiorari. As El Paso states at page 4 of its Supplemental Memorandum, "the settlement arrangements provide a reasonable, prudent, public interest resolution of a broad spectrum of issues that must be resolved irrespective of the Court's decision on the merits of these cases."

The settlement is a compromise. Neither Tenneco Oil and Conoco on the one hand nor El Paso and its customers on the other achieve all objectives that might result from continued litigation. No settlement will appease those who insist on no compromise. It is not difficult to select elements of the compromise that are less desirable to either side than one's expectations, however unrealistic the expectations may be, and to ignore the successes of negotiation. The settlement must be viewed as a whole.

Under the Commission's regulations, a proposed settlement must be accompanied by an "offer of settlement" that explains the basis of the settlement and relates the terms to the public interest. *See* Commission Rules of Practice and Procedure, 18 C.F.R. § 385.602(c) (1983).

El Paso, Tenneco Oil and Conoco filed such an offer of settlement on May 18, 1984. Tenneco Oil and Conoco have included the offer of settlement as an appendix filed herewith under separate cover for the information of the Court. In addition, the entire settlement filed at the Commission on May 18, 1984, including all agreements, representations and warranties, has been lodged with the Clerk.

The settlement filed by Tenneco Oil, Conoco and El Paso has no bearing on whether the lease sales to El Paso in the 1950's are subject to jurisdiction under the *Rayne Field* doctrine. *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965). The Court of Appeals has unanimously decided that the lease sales to El Paso do not meet the standards set by this Court in *Rayne Field*. For the reasons set forth in the "Brief in Opposition of Respondents Tenneco Oil Company, *et al.*," the petitions for writs of certiorari should be denied.

Respectfully submitted,

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June 13, 1984

Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443, 83-1618

In The
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On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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APPENDIX TO THE SUPPLEMENTAL MEMORANDUM OF RESPONDENTS TENNECO OIL COMPANY AND CONOCO INC.

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APPENDIX

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

El Paso Natural Gas Company	)	Docket No. CP74-314
Sun Exploration and	)	
Production Company, *et al.*	)	Docket No. CI77-526
El Paso Natural Gas Company	)	Docket No. CI83-356
Tenneco Oil Company	)	Docket No. CI84-49
Conoco Inc.	)	Docket No. CI84-50

OFFER OF SETTLEMENT AND JOINT REQUEST FOR APPROVAL OF STIPULATION OF SETTLEMENT AND AGREEMENT

El Paso Natural Gas Company ("El Paso"), Tenneco Oil Company ("Tenneco Oil") and Conoco Inc. ("Conoco"), pursuant to Rule 602 of the Rules of Practice and Procedure (18 C.F.R. § 385.602) of the Federal Energy Regulatory Commission,[1] hereby jointly submit this Offer of Settlement in the above-captioned proceedings. Each respectfully requests that the Commission promptly approve the attached "Stipulation of Settlement and Agreement" ("Settlement"), together with all related Operative Agreements, as a full, fair, final and reasonable resolution of such proceedings as they affect El Paso, Tenneco Oil and Conoco, and issue all approvals and authorizations necessary for effectuation of this settlement.[2]

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[1] The Federal Energy Regulatory Commission, and its statutory predecessor, the Federal Power Commission, are collectively referred to herein as the "Commission."

[2] The Explanatory Statement requested by Rule 602 is incorporated in this Offer of Settlement. A form of Commission order approving the settlement is attached as Appendix A hereto.

INTRODUCTION

This joint Offer of Settlement will resolve all outstanding issues related to those gas lease sale agreements ("GLA's") between El Paso, Tenneco Oil and Conoco, hereinafter referred to as GLA's 47, 52, 60 and 78.

Although relating to only four of eighteen GLA's at issue in Docket No. CP74-314, *et al.*, production attributable to these four GLA's constitutes approximately 70 percent of total production on all GLA's and approximately 15 percent of El Paso's total gas supply from the San Juan Basin. Thus, settlement by these parties will resolve as to the great majority of the gas involved in Docket Nos. CP74-314, *et al.* and CI83-356 and as to Docket Nos. CI84-49 and CI84-51 in their entirety, all issues as between El Paso, Tenneco Oil and Conoco raised in highly complex litigation which has already consumed eleven years without resolution, and will secure for El Paso and its customers the benefits described herein.

Because this Settlement will resolve the overwhelming majority of the litigation in the above dockets, Applicants request its expeditious consideration and approval.

The nature of the settlement and the reasons why it should be promptly approved are described below:

I.

BACKGROUND

The subject of the controversy between El Paso and Tenneco Oil and Conoco, and the subject of the Offer of Settlement herein, are the GLA's entered into between El Paso and predecessors-in-interest of Tenneco Oil and Conoco in the early 1950's. The GLA's conveyed to El Paso the working interests held by the predecessors of Tenneco Oil and Conoco in oil and gas leases in the San Juan Basin area of New Mexico. GLA-47, the first of the GLA's involved in this proceeding, and the largest, was signed on January 18, 1952 and covered 102,400 acres.

GLA-52, signed on April 19, 1952, covered 29,600 acres. GLA-60 was signed on September 26, 1952 and covered 3,500 acres. GLA-78, signed on July 8, 1953, covered 10,500 acres. The four GLA's in which Tenneco Oil and Conoco presently have an interest are among a series of GLA's entered into between El Paso and various lease owners in the San Juan Basin in the 1950's.

The GLA's reserved to the predecessors-in-interest of Tenneco Oil and Conoco an overriding royalty on gas calculated in a number of cents per Mcf, which amount escalated over time pursuant to a schedule in each GLA. The GLA's provided for redetermination of the overriding royalty through negotiation or arbitration at specified intervals. The GLA's stated that if the overriding royalty was to be redetermined by a board of arbitration, the arbitrators were to base their decision on the then current field prices of then newly negotiated contracts for gas purchased by El Paso. The GLA's also reserved to the predecessors-in-interest of Tenneco Oil and Conoco an overriding royalty of one-third of the net liquids extracted from the gas stream, to be taken in value or in kind.

Tenneco Oil and Conoco succeeded to their interests in GLA's 47, 52, 60 and 78 in 1964 as a result of their acquisition of certain of the assets of the Delhi-Taylor Oil Corporation ("Delhi-Taylor"), which had succeeded to the rights under these GLA's. At the present time, Tenneco Oil and Conoco share an equal and undivided interest in each of the GLA's.[3]

In 1973, negotiations between Sun Oil Company ("Sun") and El Paso failed to achieve redetermination of the overriding royalty on gas under GLA-61, one of

[3] In 1964 Tenneco Oil and Conoco also succeeded to the interests of Delhi-Taylor in other properties in the San Juan Basin and elsewhere. Included among the interests to which they succeeded are gas sales contracts entered into between Delhi-Taylor (and others) and El Paso in the San Juan Basin.

the GLA's that is similar to GLA's 47, 52, 60 and 78 and involved in the above-referenced proceedings, but not a subject of this Settlement. Sun sought arbitration of the amount of the overriding royalty in accordance with the terms of GLA-61, and a board of arbitration awarded Sun an increase in its overriding royalty from 10 cents per Mcf to 40 cents per Mcf on July 31, 1973. Demands for similar increases in overriding royalties thereafter were made by Tenneco Oil and Conoco and other overriding royalty owners pursuant to the arbitration clauses and favored nations clauses in their GLA's.

In response to these demands, El Paso initiated suit in the United States District Court for the District of Columbia on September 14, 1973, seeking: 1) an injunction against enforcement of the Sun arbitration award; 2) an injunction against further arbitrations; 3) to avoid claims under favored nations clauses in the GLA's; and 4) declaratory judgment that the GLA transactions were price regulated sales of natural gas within the meaning of Section 1(b) of the Natural Gas Act.[4] The United States District Court for the District of Columbia consolidated the individual cases and transferred them to the Western District of Texas.

On June 3, 1974, El Paso filed a complaint with the Commission in Docket No. CP74-314, one of the Dockets herein, requesting the Commission to determine that the GLA's were jurisdictional sales of gas under the Natural Gas Act. El Paso requested that the Commission seek a reference from the District Court on the issue of jurisdiction. El Paso at the same time moved the District Court to refer the case to the Commission. Neither motion was granted.

In 1974, El Paso sought Commission approval to include in its rates its potential increased overriding roy-

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[4] 15 U.S.C. § 717(b).

alty liability under the GLA's resulting from arbitration awards or other price redeterminations. On July 15, 1974, the Commission issued an order denying El Paso rate coverage for increased overriding royalties where the liability to pay was unclear, the amount to be paid was "very uncertain," and El Paso had not yet made such increased payments.[5]

Thereafter, El Paso and Tenneco Oil and Conoco, and El Paso and the other GLA owners, signed a series of Settlement Agreements, effective October 29, 1974, by which, among other things, the level of the overriding royalty on gas under the GLA's was established for the period from June 1, 1974 forward.[6] The 1974 Settlement Agreements provided for redetermination of the overriding royalty amount on June 1 of each subsequent year according to a formula set out in the Agreements.

After the execution of the 1974 Settlement Agreements, El Paso renewed its request to the Commission to be allowed to recover the overriding royalty amounts which were then paid under the 1974 Settlement Agreements.[7] On February 16, 1977, the Commission issued an order approving a settlement of several El Paso rate cases, and permitting El Paso to recover the overriding royalties paid under the 1974 Settlement. The Commission found that El Paso acted prudently both in entering into the original GLA's in the 1950's and in entering into the Settlement Agreements with Tenneco Oil and Conoco and the other GLA owners in 1974,[8] in light of El Paso's

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[5] El Paso Natural Gas Co., 52 F.P.C. 101, 103 (1974).

[6] The settlement rate agreed upon was the highest rate of general applicability prescribed or permitted by the Commission, less seven cents.

[7] *See* El Paso Natural Gas Co., Docket Nos. RP72-150, *et al.*

[8] *Id.* at 998-99. Specifically with respect to the 1974 Settlement Agreements the Commission stated: "We have determined the settlement rates to be prudent in light of the circumstances." *Id.* at 1001.

reservations in the 1974 Settlement Agreements of the right to actively pursue the pending litigation, and El Paso's agreement to flow through all refunds ultimately obtained in such litigation.[9] The Commission concluded, "the net impact of El Paso's settlement appears to be the most favorable alternative for El Paso and its customers."[10]

The jurisdiction issue was tried before the United States District Court for the Western District of Texas. In 1977, the court held that the GLA transactions are not sales of gas subject to the Natural Gas Act and dismissed the case for lack of subject matter jurisdiction.[11]

After the issuance of the District Court decision, the Commission on June 3, 1977 instituted a show-cause proceeding in Docket Nos. CP74-314, CP76-327 and CI77-526 on the issues of: 1) Natural Gas Act jurisdiction over the GLA's; and 2) the actions that should be taken by the Commission in the event jurisdiction were found to exist.[12]

The show-cause proceeding instituted by the Commission included as parties El Paso and the GLA owners, including Tenneco Oil and Conoco, and Northwest Pipeline Corporation ("Northwest") and the owners of overriding royalties under "Pacific" lease agreements ("PLA's") entered into in the 1950's with Pacific Northwest Pipeline Company, the predecessor of Northwest. The PLA's were similar in many respects to the GLA's entered into by El Paso. Northwest had intervened in the District Court litigation with respect to one PLA,

[9] El Paso Natural Gas Co., 57 F.P.C. 989 (1977).

[10] *Id.* at 1000.

[11] El Paso Natural Gas Co. v. Sun Oil Co., 426 F. Supp. 963 (W.D. Tex. 1977).

[12] El Paso Natural Gas Co., 58 F.P.C. 2181 (1977).

PLA-13. Northwest had been granted intervention in the Commission proceeding in 1976.[13]

In an order issued on September 25, 1980,[14] the Commission affirmed an Administrative Law Judge decision in the show-cause proceeding in which the GLA's and PLA's were determined to constitute jurisdictional sales of gas.[15] In its order, the Commission called for further proceedings before a Presiding Administrative Law Judge to determine:

> (1) whether and if so to what extent were the payment made by El Paso, Northwest and PNW to the overriding royalty owners excessive and therefore unlawful, (2) what if any amount should be required to be refunded by the royalty owners to El Paso and Northwest and flowed through by them to their jurisdictional customers, and (3) what level of royalties should be approved for the future.[16]

Petitions for review of the Commission decision on jurisdiction were consolidated with the appeal by El Paso from the District Court judgment before the United States Court of Appeals for the Fifth Circuit. At the same time, "remedy" proceedings commenced herein before the Presiding Administrative Law Judge. Prepared direct testimony and proposed exhibits were filed by El

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[13] El Paso Natural Gas Co., 55 F.P.C. 1677 (1976). Tenneco Oil and Conoco and others filed petitions for review of the Commission order instituting the show-cause proceeding. These petitions were consolidated with the appeal from the District Court decision filed by El Paso in the United States Court of Appeals for the Fifth Circuit. The Court of Appeals deferred decision on the issue of Natural Gas Act jurisdiction until the Commission issued an order in Docket No. CP74-314, *et al.* Tenneco Oil Co. v. FERC, 580 F.2d 722 (5th Cir. 1978).

[14] El Paso Natural Gas Co., 12 F.E.R.C. ¶ 61,296 (1980).

[15] El Paso Natural Gas Co., 6 F.E.R.C. ¶ 63,037 (1979).

[16] 12 F.E.R.C. at 61,685.

Paso, Northwest, and the GLA owners. A hearing on the remedy phase was scheduled to begin on September 12, 1983.

On July 5, 1983, the Court of Appeals reversed the Commission order and affirmed the judgment of the District Court, holding that the GLA's and PLA's do not constitute jurisdictional sales of gas under the Natural Gas Act.[17] The Fifth Circuit denied petitions for rehearing and suggestions for rehearing *en banc* by an unpublished order dated December 2, 1983. Petitions for a writ of certiorari have been filed in the United States Supreme Court by several parties to the proceedings.[18] No action yet has been taken by the Supreme Court on these petitions.

Following the Fifth Circuit's holding of nonjurisdiction in *Sun Oil* and the decision of the Supreme Court of the United States one week earlier that pipeline produced gas is subject to "first sale" treatment under the Natural Gas Policy Act,[19] *Public Service Commission v. Mid-Louisiana Gas Co.*,[20] El Paso on August 1, 1983, served notice on the GLA interest owners that it was reassign-

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[17] El Paso Natural Gas Co. v. Sun Oil Co., 708 F.2d 1011 (Former 5th Cir. 1983). As a consequence of the Fifth Circuit decision the Presiding Administrative Law Judge suspended the remedy proceedings in these Dockets.

[18] Petitions have been filed in the following cases: California, *et al.* v. Tenneco Oil Co., *et al.*, No. 83-1321; Public Utility Commissioner of Oregon, *et al.* v. Phillips Petroleum Co., *et al.*, No. 83-1432; Northwest Pipeline Corp., *et al.* v. Phillips Petroleum Co., *et al.*, No. 83-1433; El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, 83-1442; Pacific Gas and Electric Co., *et al.* v. Tenneco Oil Co., *et al.*, No. 83-1443; FERC v. Tenneco Oil Co., *et al.*, No. 83-1618.

[19] 15 U.S.C. § 3301, *et seq.* [hereinafter cited as the "NGPA"].

[20] —— U.S. ——, 103 S. Ct. 3024 (1983) [hereinafter cited as "*Mid-La*"].

ing to them unilaterally, effective October 1, 1983, all leasehold and other interests conveyed under the GLA's.[21]

Also on August 1, 1983, El Paso instituted suit in a state district court in Harris County, Texas in which Tenneco Oil and Conoco, among other GLA owners, were named as defendants.[22] In its petition El Paso sought a declaratory judgment under the Texas Declaratory Judgments Act[23] that certain specified provisions in the GLA's entitled El Paso to reassign to Tenneco Oil and Conoco and the other GLA owners the rights El Paso held under the GLA's. Tenneco Oil and Conoco and the other GLA owners thereafter filed answers denying El Paso's claims and asserting counterclaims against El Paso.

Concurrent with the filing of its petition in Texas state court, El Paso filed a petition with the Commission in Docket No. CI83-356 in which it noted its tendered reassignment of its lease rights under the GLA's and requested the Commission to order Tenneco Oil and Conoco and the other GLA owners to apply for and obtain certificates under Section 7(c) of the Natural Gas Act for sales of gas from the GLA acreage to El Paso.[24] Tenneco

[21] Such reassignments were based upon provisions in the GLA's that El Paso asserted permitted it to reassign any well the operation of which had become unprofitable and, in the case of certain leases, provisions in the GLA's which El Paso asserted provided for a conversion from a royalty to a working interest upon the occurrence of a specified event. Because five of the GLA's—GLA's 153, 348, 349, 350 and 351—were not subject to such asserted rights of reassignment, El Paso's tender of reassignment as to those GLA's was subject to acceptance by the GLA owners.

[22] El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (11th Judicial District, Harris County, Texas).

[23] Tex. Rev. Civ. Stat. Ann. art. 2524-1 (Vernon 1965 and Vernon Supp. 1982).

[24] El Paso Natural Gas Co., FERC Docket No. CI83-356, "Petition of El Paso Natural Gas Company for Issuance of Commission

Oil and Conoco and other GLA owners filed petitions for leave to intervene in Docket No. CI83-356 and protests and objections to El Paso's petition.[25]

Solely as a protective matter, in order to protect their rights in the event the Commission initiated action in conjunction with El Paso's petition in Docket No. CI83-356, Tenneco Oil and Conoco each filed conditional applications for certificates of public convenience and necessity under Section 7(c) of the Natural Gas Act covering sales of gas from the GLA properties to El Paso. These applications for conditional certificates were filed on November 2 and 3, 1983 in Docket Nos. CI84-49 and CI84-51.[26] El Paso filed motions to intervene in both of these Dockets on December 7, 1983.[27] To date, no action has been taken by the Commission either on El Paso's petition in Docket No. CI83-356 [28] or on Tenneco Oil and

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Order" (filed August 1, 1983). In its petition El Paso asserted that it was not required to obtain abandonment approval under Section 7(b) of the Natural Gas Act for the transfer of production properties and facilities subject to Commission jurisdiction. El Paso claimed that the transfer merely shifted the service obligation as to dedicated gas to Tenneco Oil and Conoco and the other GLA owners. El Paso Petition at 10-11.

[25] *See* El Paso Natural Gas Co., Docket No. CI83-356, "Petition for Leave to Intervene and Protest of Undersigned Companies and Persons" (filed August 26, 1983).

[26] Tenneco Oil Co., Docket No. CI84-49, "Application of Tenneco Oil Company for Conditional Certificate of Public Convenience and Necessity" (filed November 2, 1983); Conoco Inc., Docket No. CI84-51, "Application of Conoco Inc. for Conditional Certificate of Public Convenience and Necessity" (filed November 3, 1983).

[27] Tenneco Oil Company, Docket No. CI84-49, "Motion To Intervene of El Paso Natural Gas Company" (filed December 7, 1983); Conoco Inc., Docket No. CI84-51, "Motion To Intervene of El Paso Natural Gas Company" (filed December 7, 1983).

[28] In an order accepting for filing and suspending El Paso's proposed tariff sheets in the purchased gas cost adjustment case filed by El Paso on August 31, 1983 in Docket No. TA84-1-33, the Com-

Conoco's applications in Docket Nos. CI84-49 and CI84-51.

Because of the decision of the United States Supreme Court in *Mid-La*, and as provided in the terms of the rate settlement entered into between El Paso and its customers that was approved by the Commission on May 31, 1983,[29] El Paso, on August 31, 1983, effected its implementation of *Mid-La, inter alia*, as to its purchased gas costs for company owned production from the GLA acreage. The Commission accepted El Paso's PGA for filing in an order dated September 30, 1983.[30]

On February 27, 1984, after a trial on the merits of El Paso's claims in Texas state court, the trial judge entered a judgment by which the relief sought by El Paso was denied. El Paso was ordered to file a notice of rescission of its attempted reassignments and was ordered to continue to perform its duties as the working interest owner under the GLA's.[31] El Paso has preserved its statutory rights with respect to an appeal.

Since the issuance of the decision in the Fifth Circuit, some of the parties to the above-referenced proceedings before the Commission have entered into settlement agreements resolving some or all of the issues involved. Specifically, a Commission order approving a Settlement Agreement between Northwest and Phillips Petroleum Company was issued on November 23, 1983.[32] In addi-

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mission ordered that acceptance of El Paso's filing was conditioned upon "the outcome of proceedings in Docket No. CI83-356 relating to GLA production." El Paso Natural Gas Co., 24 F.E.R.C. ¶ 61,390 at 61,827 (1983).

[29] El Paso Natural Gas Co., 23 F.E.R.C. ¶ 61,365 (1983).

[30] El Paso Natural Gas Co., 24 F.E.R.C. ¶ 61,390 (1983).

[31] El Paso Natural Gas Co. v. Tenneco Oil Co., No. 83-50539, Judgement entered Feb. 29, 1984 (Dist. Ct. Harris County, Texas).

[32] 25 F.E.R.C. ¶ 61,292 (1983).

tion, Northwest and Getty Oil Company filed an Offer of Settlement with the Commission on January 31, 1984. The Presiding Administrative Law Judge certified the uncontested Offer of Settlement to the Commission on February 24, 1984.[33]

Finally, El Paso and Union Oil Company of California ("Union") entered into a settlement agreement with respect to the litigation in the State District Court in Harris County, Texas by which Union accepted El Paso's tendered reassignment of the lease rights and acreage under GLA-76, GLA-348 and GLA-349. The gas sales contract between Union and El Paso, dated October 1, 1983, is the subject of a Section 7(c) certificate application in Docket No. CI84-141.[34]

II.

SUMMARY OF THE PROPOSED SETTLEMENT

A. *The Stipulation of Settlement and Agreement*

The Settlement and the Operative Agreements resolve for all purposes all issues in these dockets as to El Paso, Tenneco Oil and Conoco by "conventionalizing" the production of natural gas from the four GLA's subject to the Settlement into sales of gas in interstate commerce for resale.

Under the terms of the Settlement, El Paso will reassign to Tenneco Oil and Conoco the interests in properties conveyed by Tenneco Oil and Conoco's predecessors-in-interest under GLA's 47, 52, 60 and 78 as of the Effective Date of the Agreement as defined in the Settlement. Under Article V of the Settlement, the Effective Date is that date on which all orders necessary to implement the

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[33] 26 F.E.R.C. ¶ 63,080 (1984).

[34] *See* Union Oil Co. of California, Docket No. CI84-141, Notice of Application for Certificate of Public Convenience and Necessity" (issued December 22, 1983).

Settlement become final, no longer subject to judicial review, and are accepted by each Applicant. Tenneco Oil and Conoco also have an option to accept the lease reassignments prior to such approvals. However, exercise of the option does not obviate the need for all Commission approvals sought herein.

B. *The Tenneco Oil and Conoco Purchase Agreements and Amendments to Gas Sales Agreements*

Upon the Effective Date, Tenneco and Conoco will commence "first sales" of natural gas in interstate commerce to El Paso in accordance with the terms and provisions of the Tenneco Oil Gas Purchase Agreement (Exhibit D) and the Conoco Gas Purchase Agreement (Exhibit E). Thereby, litigation which has been pending before this Commission and various courts over the last eleven years as to whether the overriding royalties attributable to these leases are jurisdictional sales of gas will be concluded. Pursuant to this Settlement, Tenneco Oil and Conoco will become first sellers clearly subject to the Commission's pricing jurisdiction. Approval of the Settlement will lift the burdens imposed by the overriding royalties, and two producers who have incentive to develop gas reserves in the Basin will take over the operation of the properties.

Under the Settlement, Tenneco Oil and Conoco will surrender their right to an overriding royalty of $3.74 per Mcf, which is scheduled to escalate to approximately $4.00 per Mcf as of June 1, 1984, and instead will be governed by the applicable maximum lawful prices. The parties have contracted for a base price of $2.00 per MMBtu, escalated with inflation, for a period through June 30, 1986, for gas not otherwise qualifying for a higher maximum lawful price, and thereafter a base price equal to the maximum lawful price established pursuant to Section 106(a) of the NGPA.

The $2.00 base price is a compromise of a dispute as to the appropriate price to be applied to such gas. Virtually all of that gas is currently priced at a replacement/rollover rate by El Paso in its implementation of *Mid-La* pricing. However, as of November 8, 1978, the relevant determination date for independent producer pricing under the NGPA, the GLA gas here involved was being priced by El Paso as pipeline production under the Natural Gas Act, and Commission orders approving such inclusion were in effect. Thus, there are bases for contending that higher rates, including the Section 109 rate, and even higher rates, could apply.

It is not necessary for the Commission to address and decide the legal questions posed on the pricing issues. Rather, Applicants submit that the pendency of these issues argue in favor of the compromise on the matter reached by the parties. The $2.00 base price is less than the Section 109 maximum lawful price, and it reduces as of July 1, 1986 to the rollover price. Even with this approach, San Juan Basin gas remains the lowest cost source of gas on the El Paso system.

At the same time, and in connection with the compromise on the base price, El Paso negotiated for and has received market-out rights exercisable in its sole discretion. Presently, El Paso has no judicially recognized contractual right to reduce the level of the much higher overriding royalties currently payable. Further, El Paso has not been successful thus far in its undertaking unilaterally to reassign the GLA properties as a means of lifting the overriding royalty burden, a fact reaffirmed as recently as February 29, 1984 by the Texas State District Court. Market-out provisions are thus critical to El Paso in providing a dependable mechanism to assure that it will be able to adjust pricing of the GLA gas to reflect market conditions as they change from time to time. Approval of the Settlement achieves this result.

The Gas Purchase Agreements contain provisions whereby El Paso will take or pay for 60 percent of the daily stabilized producing capacity of each well for the first two years of the two agreements. Thereafter, El Paso will take 75 percent of gas well deliverability under the Tenneco Oil contract and 85 percent of gas well deliverability under the Conoco contract.[35]

Article III of the Tenneco Oil Gas Purchase Agreement and Article IV of the Conoco Gas Purchase Agreement reserve to Tenneco Oil and Conoco the right to process all gas subject to those agreements. After all regulatory approvals have been obtained, Tenneco Oil and Conoco have the right to construct at their sole cost and expense a new, efficient liquids processing plant using modern technology (referred to herein as the New Blanco Plant). Until the construction of the New Blanco Plant, Tenneco Oil and Conoco will have the right to use El Paso's processing facilities located in the San Juan Basin, (commonly referred to as the San Juan, Chaco and Blanco Plants or the El Paso Complex), in accordance with the provisions of the El Paso Complex Gas Processing Agreement (Exhibits M and N). Once the New Blanco Plant is built, Tenneco Oil and Conoco will process all gas sold to El Paso under the Agreements in that Plant.

Pursuant to Article IV of the Tenneco Oil Gas Purchase Agreement and Article III of the Conoco Gas Purchase Agreement, Tenneco Oil and Conoco each have reserved the right to withhold from sale to El Paso up to 25 percent of their respective pro-rata share of proved

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[35] Because of the way in which the take-or pay is structured in the Conoco contract, the 85 percent take-or-pay currently translates into an effective rate of 74.4 percent. Further, because of the exclusion of certain higher cost gas from the calculation in effecting such reduction, the overall effect is to reduce the economic consequences of the take-or-pay. El Paso's take-or-pay obligation under both contracts is subject to further reduction under circumstances specified therein.

recoverable gas reserves not subject to the requirements of Section 7(b) of the Natural Gas Act; and El Paso has released and waived any rights thereto granted by Section 315(b) of the NGPA if the reserved gas is sold to an affiliate. In addition, Tenneco and Conoco each have reserved the right to terminate their respective Gas Purchase Agreements with respect to any gas as to which El Paso has exercised its contract right to "market out" by lowering the "first sales" price to that determined by El Paso to be the value of the gas to El Paso and which is not subject to the abandonment requirements of Section 7(b) of the Natural Gas Act.

The gas subject to the reservation and release is limited to gas not subject to the requirements of Section 7(b) of the Natural Gas Act. Tenneco Oil and Conoco do not have any reservation or market-out release claims as to the older, lower cost gas, thereby preserving the benefit of this lower cost gas for El Paso's customers.

At the same time, however, Tenneco Oil and Conoco have the right to commit their currently undedicated acreage in the San Juan Basin under these Agreements. Thereby, El Paso has gained a preferential contracting position as to future development on any of Tenneco Oil and Conoco's undrilled acreage in the Basin.

El Paso and Conoco and El Paso and Tenneco Oil have amended those existing gas purchase contracts referenced in Appendix A of the Tenneco Amendment of Gas Purchase Contracts (Exhibit D-1) and Exhibit A of the Conoco Amendment of Gas Purchase Contracts (Exhibit E-1) to provide Tenneco Oil and Conoco the right to process all gas sold under such gas sales contracts on the same terms and conditions as provided for in the Gas Purchase Agreements, the El Paso Complex Processing Agreement and the Gas Plant Straddle and Processing Agreement.

C. *Gas Gathering and Transportation Agreements*

Pursuant to the Gas Gathering and Transportation Agreements (Exhibits F-1, F-2, G-1, G-2, H and I), El Paso will gather and transport, on behalf of Tenneco Oil and Conoco, that gas reserved by Tenneco and Conoco and that gas subject to release from the provisions of each Gas Purchase Agreement by virtue of El Paso's exercise of its "market out" right. El Paso's obligation to gather and transport such gas on behalf of Tenneco Oil and Conoco is on a best efforts basis, subject to capacity being available in El Paso's gathering and transportation facilities.

The charges for transportation (gathering) by El Paso shall be those rates in effect and reflected from time to time as the "Production Area Charges—Field Gathering" set forth in El Paso's FERC Gas Tariff, Third Revised Volume No. 2 or any superseding tariff. The rates to be charged by El Paso for all forward haul transportation for the account of Tenneco and Conoco shall be those reflected from time to time as the "Mainline Transmission Charges" set forth in El Paso's FERC Gas Tariff, Third Revised Volume No. 2, or any superseding tariff. The back haul transportation rates to be charged by El Paso shall be equal to one-half of the forward haul transportation rates, as reflected in El Paso's FERC Gas Tariff, Third Revised Volume No. 2 or any superseding tariff.

D. *El Paso Complex Gas Processing Agreement*

The El Paso Complex Gas Processing Agreement provides that El Paso will process for Tenneco Oil and Conoco all gas produced in the San Juan Basin and sold by Tenneco Oil and Conoco to El Paso, including under both the Tenneco Oil and Conoco Gas Purchase Agreements, as well as any other gas sales contract entered into between the parties on or after the Effective Date of the Settlement. The Complex Gas Processing Agreement provides

that for the first five years of such agreement, El Paso will deliver to Tenneco Oil and Conoco at the tailgate of its Complex processing facilities, 77 percent of the liquefiables recovered from processing. For a period of five years thereafter, El Paso will deliver to Tenneco Oil and Conoco not less than 72 percent of the liquefiables recovered in processing. Provision is made for redetermination each five (5) years.

E. *Lease, Plant Siting Agreement and Gas Plant Straddle and Processing Agreement*

Pursuant to the terms of the Plant Siting Agreement between El Paso, Tenneco Oil and Conoco (Exhibit K), El Paso has leased to Tenneco Oil and Conoco approximately 30 acres of land located in the vicinity of El Paso's existing Blanco processing plant and agreed to assist and cooperate with Tenneco Oil and Conoco in their construction and operation of the New Blanco Plant which will have a design throughput capacity of 500 MMcf per day. Tenneco Oil and Conoco's right to construct and operate the New Blanco Plant is expressly conditioned upon receipt and acceptance of all regulatory approvals necessary for such construction and operation, including but not limited to all authorizations by this Commission.

Pursuant to the terms of the Gas Plant Straddle and Processing Agreement (Exhibit L), Tenneco Oil and Conoco will each commit its gas for processing in the Plant. El Paso will, for a period of twenty years, deliver to the New Blanco Plant all volumes of Tenneco Oil and Conoco gas which they have committed to El Paso under the Tenneco Oil and Conoco Gas Purchase Agreements, the Amendments to Gas Purchase Agreements and from other San Juan Basin producers whose gas is being processed in the Plant, and will supply . volume of El Paso's gas equal to the difference of those volumes of

gas processed by Tenneco Oil and Conoco for their own account and the account of others and the operational capacity of the plant. El Paso's obligations are subject to the market demand situation on its system.

In consideration for the processing of El Paso gas at the New Blanco Plant, Tenneco Oil and Conoco will receive a processing fee equal to 39 percent of the recovered liquefiable hydrocarbons. In the event Tenneco Oil and Conoco process for others at a lower processing fee, El Paso has the right to the lower processing fee.

The Straddle and Processing Agreement requires El Paso to construct and operate those tap and appurtenant facilities necessary for the delivery of gas to and acceptance of gas from the New Blanco Plant, and to make such modifications as are required for it to meet its obligations under the terms of that Agreement. It further provides that Tenneco Oil and Conoco will install and operate secondary inlet compression of at least 10,000 horsepower. Tenneco Oil and Conoco may request El Paso to shut down or idle existing compressors at the Blanco site in connection with the operation of the New Blanco Plant, but Tenneco and Conoco will replace all additional amounts of compression or horsepower which it requests El Paso to shut down or idle, subject to the 10,000 horsepower floor.

F. *Transportation and Fractionation*

El Paso will provide Tenneco Oil and Conoco with transportation and fractionation services in connection with the plant products extracted in the processing of gas in the San Juan Basin. Fractionation will be provided at a rate of 4 cents per gallon, subject to escalations for increases in costs. In the event Tenneco Oil

and Conoco build liquid transportation facilities, they will provide El Paso *pro rata* access to the facilities.

G. *Refunds*

Pursuant to Article VI of the Settlement, Tenneco Oil and Conoco each shall refund to El Paso, within 30 days of issuance of final and nonappealable orders approving this Offer of Settlement, a sum of $25,000,000, for a total of $50,000,000, in settlement of all past, present and future claims arising out of or in any way related to these docketed proceedings. These refunds are to be flowed through by El Paso to its customers under the terms of prior rate settlements. The refunds are payable without regard to whether or not the Supreme Court denies certiorari.

H. *Termination*

The Settlement may be terminated at the earlier of any of the following dates: (a) by either side if final Commission approval in a form satisfactory to such party has not issued within 15 months after the date of execution, (b) by Tenneco Oil and Conoco if such final approval has not issued within 180 days following denial of certiorari in the litigation now pending before the Supreme Court, and (c) by El Paso, if such final approval has not issued within 30 days following the final reversal of the decision in *Sun Oil, supra.* In addition, if the orders are unacceptable, any of the parties have the right to terminate the Settlement Agreement.

Because the right to terminate arises in the event that the approvals are no longer subject to judicial review, expeditious consideration by this Commission is necessary to assure that approvals become final before the termination rights arise.

III.

APPROVAL OF THE SETTLEMENT IS IN THE PUBLIC INTEREST

A. *Future Purchases on Reasonable Terms.*

Under the GLA's, El Paso is presently required to pay an amount of overriding royalty—$3.74 per Mcf—greatly exceeding the revenues it receives upon sale of the GLA production pursuant to its implementation of the Supreme Court's *Mid-La* decision even without considering El Paso's other costs of production. As a consequence, development of the GLA acreage has not proceeded at the optimum level.

The Settlement Agreement eliminates this burden on development and promotes the interests of El Paso and its customers by transferring ownership and operational control of the GLA properties to Tenneco Oil and Conoco and extinguishing the overriding royalty. Tenneco Oil and Conoco will then be able to develop and produce the properties in a manner best suited to providing gas for sale to El Paso at prices advantageous to El Paso's customers.

For their part, Tenneco and Conoco have agreed to the new arrangements on the condition that they receive no less than the normal incidents of a working interest. Thus, for example, they have insisted on the right to process the reassigned reserves for the extraction of natural gas liquids. Moreover, they have insisted upon at least partial recognition of their claim to certain rates under the NGPA.

In the Gas Purchase Agreements negotiated as a part of the total settlement, El Paso has agreed to pay the maximum lawful price established under Sections 102, 103, 107, or 108 for all gas qualifying under those sections, subject to El Paso's "market out" rights. For all other gas, the settlement provides a price of $2.00 per

MMBtu (as adjusted for inflation from the date of the settlement) through the period ending June 30, 1986, and the maximum lawful price established under NGPA Section 106(a) thereafter (currently 88.5¢ per MMBtu for pre-1973 wells). In view of the substantial benefits otherwise obtainable under the settlement and the fact that the GLA production in the aggregate continues to be priced substantially below the price of most of El Paso's alternate supplies, the settlement prices constitute a fair and reasonable resolution of the outstanding pricing issues.[36]

As to this production, there can be no doubt that in the absence of the agreed-to resolution, the appropriate pricing of this gas could be subject to litigation for years. Correct application of the NGPA to GLA production is not clear, nor is the impact of the *Mid-La* decision certain. Legal arguments have been raised which, if accepted, would result in even higher prices for the indefinite future than proposed here. By comparison, not only is the $2.00 Settlement rate for only a two-year period, but thereafter, the Settlement provides that the rate is reduced to the maximum lawful price established under Section 106(a) of the NGPA.

The customers secure significant benefit from this compromise of the pricing issue. Rather than having the pricing issue open for years with the attendant uncertainty and resulting disincentives to the fullest exploitation of these reserves, and with the concomitant possi-

[36] There is no issue concerning the Commission's statutory authority to approve the $2.00 price. Either the wells in question are subject to Section 109, in which case the price is lawful by definition, or the wells are subject to Section 104. In the latter event, if a higher rate does not otherwise apply, the Commission is authorized to increase the statutory ceiling if the new ceiling is "just and reasonable" within the meaning of the Natural Gas Act. Section 104(b)(2). In view of the benefits of the Settlement, such a finding is clearly permissible.

bility of far higher payments for the indefinite future, they are assured of the certainty of specified prices significantly below other potential prices; these prices decline still further after a two-year period. At the same time, with the uncertainty as to pricing removed, Tenneco and Conoco would be able to engage in the timely development of the reconveyed properties, securing for the customers the benefits of a long-term supply not currently subject to deregulation. When the protection of the market-out is added, it can be seen that the customers of El Paso achieve significant benefits from the pricing under the terms of the Settlement.

Further, the proposed sales and processing arrangements will lead to lower rates for El Paso's customers than would prevail in the absence of the Settlement. So long as El Paso continues to operate under the GLA's, it remains subject to a royalty obligation that imposes a substantial loss on El Paso with respect to virtually each Mcf of gas produced from these GLA's. The inevitable consequence is that El Paso simply cannot justify further development of the GLA reserves (or, indeed, of non-GLA reserves underlying the same acreage) beyond the minimum level necessary to maintain its leases and fulfill its other obligations. By comparison, application of the pricing proposed under the terms of the Settlement renders these untapped reserves available at a price to the consumer lower than that commanded by El Paso's alternate gas sources and which, under current law, is not scheduled to be deregulated as to price. The effect of this curtailed supply, not subject to price deregulation, obviously becomes more pronounced over time as older and cheaper supplies are depleted and as the scheduled January 1, 1985 deregulation of most new sources of gas becomes imminent.

Moreover, under conditions prevailing today, the deliverability of supplies attached to El Paso's system is markedly in excess of demand. This has required El Paso

to curtail production below to take-or-pay levels in most supply areas. One result of such cut backs has been that natural gas liquid production in the San Juan Basin has suffered proportionately. Since the revenues from such liquids are credited to El Paso's cost of service (currently under a "tracking" procedure approved in Docket No. RP82-33-000), El Paso's rates are adversely affected for this reason as well. Once market conditions improve, higher San Juan production will result in correspondingly higher net liquid revenue credits as higher throughput in a more efficient plant is achieved.

Under the Settlement, arrangements are thus put in place which should directly help to stabilize, and ultimately lower, El Paso's rates to its customers. Most critically, the Settlement removes the burden of the special overriding royalties now payable to Tenneco Oil and Conoco and, with them, the existing impediment to further drilling.

In addition, the Settlement contemplates the construction of a substantially more efficient natural gas liquid extraction facility.[37] By permitting optimal liquid recovery, and price certainty, the new arrangements will provide a powerful stimulus to further development of the San Juan Basin. Insofar as El Paso and its ratepayers are concerned, such newly developed production will directly displace more expensive supplies that would otherwise be purchased, and El Paso's revenues from the incremental liquid production will be available to reduce El Paso's cost of service.

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[37] The existing Blanco Plant was originally constructed in 1953 and expanded in 1956. Using the technology of its day, the facility was able to recover all butanes and heavier hydrocarbons but only approximately 25 percent of the propane and virtually none of the ethane in the processed gas. In contrast, the New Blanco Plant will use a modern cryogenic process to recover approximately 80 percent of the ethane and essentially all heavier hydrocarbons.

Projections concerning the economic impact of these changes beyond the near term future are difficult because of their sensitivity to assumptions regarding future prices. On a conservative basis, however, El Paso estimates that while the initial impact of the Settlement will be an increase over the rates currently being charged, this increase is offset within a relatively short time, and El Paso's cost of service will then be lower (on an annual basis) than it would be in the absence of the Settlement. If more favorable but still reasonable assumptions are made regarding future natural gas liquid prices, the initial rate increases are reduced and the overall cost savings are increased.

However, current rate levels are only one of the numerous benchmarks against which the benefits of the settlement must be measured. Difficult issues with respect to the application of the NGPA and the *Mid-La* decision to GLA pricing are open and unresolved. They may remain unresolved for an extended time, and when resolved, higher rates then these resulting from the Settlement may result. By removing the source of this difficulty—pricing of GLA production, the Commission will help ensure that no such rate increase will be needed to respond to NGPA and *Mid-La* issues relating to the GLA production.

B. *Enhanced Gas Supply*

As discussed above, under the current level of special overriding royalty, El Paso simply cannot justify development of the GLA acreage beyond the levels required to meet El Paso's obligations. Since every dollar spent on such development is accompanied by a fully predictable loss on the investment, El Paso does not have the motivation to maximize development of the GLA properties.

Contrasted with this circumstance is the fact that El Paso projects the present deliverability surplus on El Paso's system to be absorbed by the market within a few

years. Further development of the GLA acreage (through early completion of the in-fill drilling program and otherwise) is therefore not only wise but absolutely necessary to avoid potentially damaging supply shortfalls. Certainly, it makes no sense to tolerate unnecessary road blocks to such development. Since prompt approval of the settlement will permit timely development of a substantial portion of such reserves, it clearly serves the public interest in this respect as well.

Further, under the Settlement and related gas purchase agreements, El Paso has the opportunity to realize significant reserve additions wholly separate from the GLA acreage. Tenneco Oil and Conoco have the option to add all of their currently undedicated acreage to their respective Gas Purchase Agreements. This gives El Paso clearly the best opportunity to secure these reserves in preference to other purchasers. Inasmuch as these reserves would likely be added at lower cost than reserves in other producing areas, the consumer again benefits. In light of these circumstances, the reservation of the 25 percent interest in the higher cost gas was a reasonable agreement in order to get access to these additional reserves.

The Settlement provides for a refund by Tenneco Oil and Conoco of $25,000,000 each, for a total of $50,000,000, in discharge of all claims arising under the GLA's. This is an appropriate resolution of the refund issue. The refund is not contingent upon whether the Supreme Court denies certiorari in the current pending cases; rather, the only condition to payment of the refund is the acceptance of this Settlement through final order no longer subject to judicial review.

Whether the customers would otherwise realize any refunds in the absence of this Settlement is problematical. Under the Fifth Circuit's decision, Tenneco Oil and Conoco owe no refunds, a result which also obtains if the

Supreme Court either denies certiorari or affirms the Fifth Circuit's decision. Even a reversal of that court's decision could result in further proceedings before the Fifth Circuit; if remedy proceedings were ultimately held before the Commission and reviewed by the courts, it could nevertheless be years before any refunds became payable. Further, arguments have been raised by Tenneco Oil and Conoco whereby they claim their refund liability has not yet begun to accrue even if the GLA's are found jurisdictional. In contrast the benefit of a present refund, currently payable, as opposed to the future contingency of an uncertain refund obligation, serves the public interest, particularly when unconditionally tied to approval of this Settlement.

The Settlement herein proposed is the product of difficult negotiations over a period of several months. By securing a substantial refund commitment notwithstanding the GLA's owners success in the courts, by placing future relations with the two principal GLA owners in a posture that achieves a stable long term supply on reasonable terms, and by doing so under arrangements which will reduce El Paso's rates below the level that would otherwise prevail, the Settlement achieves a fair balance in view of all the surrounding circumstances. This proposed resolution is accordingly fair, responsible and in the public interest and should be approved.

IV.

SPECIFIC AUTHORIZATIONS REQUESTED

El Paso, Tenneco Oil and Conoco respectfully request that the Commission's order approving the Settlement find it and all Operative Agreements described in Article V thereof, to be reasonable, prudent and in the public interest. El Paso, Tenneco and Conoco further request that such order specifically grant the following approvals and authorizations:

A. *Transfer of Leaseholds and Appurtenant Property*

Pursuant to Article V of the Settlement, El Paso will reconvey on the Effective Date of the Settlement to Tenneco and Conoco those interests in the leases and certain assets situated thereon associated with their reserved overriding royalty interests under GLA's 47, 52, 60 and 78. Until the Effective Date, gas produced from those properties will continue to flow to El Paso in interstate commerce. After the Effective Date, Tenneco and Conoco will commence "first sales" of the natural gas in interstate commerce to El Paso in accordance with the terms and provisions of the Tenneco Oil and Conoco Gas Purchase Agreements. Thus, under the structuring of the Settlement, there will be no cessation of the flow of gas to El Paso for resale in interstate commerce. The gas being sold to El Paso in the resulting sale by Tenneco and Conoco will be subject to the Commission's jurisdiction under Section 7(c) of the Natural Gas Act, except to the extent exempted from the requirements of that Act under Section 601 of the NGPA. Accordingly, El Paso applies for any necessary authorizations required under this Natural Gas Act to effect the transfer of the interests in the leases and related assets to effect the transactions contemplated by the Settlement, including, if required, any abandonment authorizations under Section 7(b) of the Natural Gas Act.

B. *Gas Purchase Agreements and Amendments to Existing Gas Sales Contracts*

Article VIII of the Tenneco Oil Gas Purchase Agreement and Article X of the Conoco Gas Purchase Agreement provide for the payment by El Paso of a base price of $2.00 per MMBtu from May, 1984 through June, 1986, escalating pursuant to Section 101 of the NGPA, for gas not otherwise qualifying for a higher maximum lawful price. Thereafter (1) all gas produced from wells drilled prior to January 1, 1973 will be priced pursuant to the provisions of Section 106(a) of the NGPA; (2) all

gas produced from wells drilled on and after January 1, 1973 and prior to January 1, 1975 will be priced pursuant to the provisions of Section 104 of the NGPA; and (3) all gas produced from wells drilled on or after January 1, 1975 will be priced in accordance with the applicable provisions of the NGPA as though such gas [had] been produced and sold by an independent producer as of November 8, 1978.

Tenneco Oil and Conoco have reserved the right in their respective Gas Purchase Agreements to process gas initially in El Paso's processing facilities located in the San Juan Basin (Commonly referred to as the San Juan, Chaco and Blanco Plants or the Complex) in accordance with the provisions of the El Paso Complex Processing Agreements. Additionally, Tenneco Oil and Conoco are obligated to process such gas in the new processing plant (the New Blanco Plant) following construction of such by Tenneco Oil and Conoco pursuant to the provisions of the Plant Siting Agreement and the Gas Plant Straddle and Processing Agreement. Finally, Tenneco Oil and Conoco may process such gas in some other plant to be located at a mutually agreed upon point in the El Paso San Juan system if for some reason the New Blanco Plant is not constructed. El Paso and Conoco and El Paso and Tenneco Oil have amended those existing gas purchase contracts referenced in Appendix A of the Tenneco Oil Amendatory Agreement (Exhibit D) and Appendix A of the Conoco Amendment of Gas Purchase Contracts (Exhibit E) to provide Tenneco Oil and Conoco the right to process all gas sold under such gas Purchase contracts on the same terms and conditions as provided for in the Gas Purchase Agreements, the El Paso Complex Gas Processing Agreement and the Gas Plant Straddle and Processing Agreement.

El Paso proposes to credit to its jurisdictional cost of service the net liquid revenues received (1) from the processing by it in the Complex of gas tendered for proc-

essing therein; (2) from the processing in the New Blanco Plant of all El Paso gas tendered for processing therein, and (3) revenues from fees charged under the Transportation and Fractionation Agreement.

Tenneco Oil and Conoco request that the Commission (a) issue certificates of public convenience and necessity authorizing the sale of gas by Tenneco and Conoco to El Paso pursuant to the terms of the Gas Purchase Agreements for that gas which remains subject to the certificate authority of the Commission under Section 7(c) of the Natural Gas Act and Section 601 of the NGPA; (b) find all rates and charges specified in the Tenneco and Conoco Gas Purchase Agreements to be "just and reasonable" under the standards of the Natural Gas Act and the NGPA; (c) approve, to the extent necessary, the reservation of processing rights in the Tenneco Oil and Conoco Gas Purchase Agreements pursuant to provisions of the Natural Gas Act, particularly Section 7(b) thereof, and any applicable provisions of the NGPA; (d) amend all certificates of public convenience and necessity, and related rate schedules, previously issued for the gas sales contracts referenced in Appendix A to the Tenneco Oil Amendatory Agreement and Exhibit A to the Conoco Amendment to Gas Purchase Contracts in accordance with the provisions of Sections 7(b) and (c) of the Natural Gas Act; and (e) approve, to the extent necessary, the amendments reserving processing rights in all other gas sales contracts referenced in Appendix A to both the Tenneco Oil Amendatory Agreement and Exhibit A to the Conoco Amendment to Gas Sales Contracts pursuant to the provisions of the Natural Gas Act and the NGPA.

El Paso requests that the Commission (a) find that the payment of all prices by El Paso under the Gas Purchase Agreements to be both prudent and just and reasonable under the standards of the Natural Gas Act and the NGPA and that El Paso will be permitted to recover in its rates and charges all prices paid to Tenneco Oil and

Conoco under the Gas Purchase Agreements pursuant to Section 601(c)(2) of the NGPA; and (b) find El Paso's proposed credit to its jurisdictional cost of service of all net liquid reserves from the processing of gas pursuant to the El Paso Complex Processing Agreement and pursuant to the provisions of the Gas Plant Straddle and Processing Agreement to be reasonable and appropriate.

C. *Transportation*

Tenneco Oil and Conoco each have reserved the right to withdraw from sale to El Paso up to 25 percent of their respective pro-rata share of proved recoverable gas reserves not subject to the requirements of Section 7(b) of the Natural Gas Act. Additionally, Tenneco Oil and Conoco each have reserved the right to terminate their respective Gas Purchase Agreements with respect to any gas which El Paso has exercised its contract right to "market out" by lowering the "first sales" price to that determined by El Paso to be the value of the gas to El Paso. This right of Tenneco Oil and Conoco to terminate is expressly limited to gas not subject to the requirements of Section 7(b) of the Natural Gas Act. El Paso has released and waived any rights granted by Section 315(b) of the NGPA as to such gas.

Pursuant to the Gas Gathering and Transportation Agreements (Exhibits F-1, F-2, G-1, G-2, H and I to the Settlement Agreement), El Paso is obligated to provide transportation services, on behalf of Tenneco Oil and Conoco, for that gas reserved by Tenneco Oil and Conoco and that gas subject to release from the provisions of each Gas Purchase Agreement by virtue of El Paso's exercise of its "market out" right. El Paso's obligation to transport such gas on behalf of Tenneco Oil and Conoco is subject to capacity being available in El Paso's gathering and transportation facilities and receipt of all necessary regulatory approvals.

The charges for transportation and gathering by El Paso shall be those rates in effect and reflected in El

Paso's FERC Gas Tariff, Third Revised Volume No. 2 or any superseding tariff.

El Paso requests that the Commission authorize and certificate the above-referenced transportation services pursuant to the provisions of Section 7(c) of the Natural Gas Act. In addition, El Paso requests that to facilitate regulatory administration, the Commission provide that a list of the receipt points added to and deleted from the Gas Gathering Agreements be filed by El Paso within ninety (90) days of the end of each calendar year.

D. *The New Blanco Plant*

In connection with the construction and operation of the New Blanco Plant, El Paso is required, pursuant to Article II of the Gas Plant Straddle and Processing Agreement, to construct and operate those tap and appurtenant facilities necessary to deliver to and accept gas from such Plant and to make any modifications required to meet its obligations thereunder. Additionally, Tenneco Oil and Conoco are required, pursuant to Article II of the Gas Plant Processing and Straddle Agreement, to install and operate at least 10,000 horsepower of secondary compression necessary for operation of the Plant, and El Paso is required, pursuant to Articles II and V of the Gas Plant Processing and Straddle Agreement, to idle or shut down reciprocating compressors located in El Paso's existing Blanco Plant. Finally, upon commencement of operations at the New Blanco Plant, El Paso is obligated to suspend certain operations at its existing Blanco Plant.

El Paso requests that the Commission (a) issue certificates of public convenience and necessity authorizing construction and operation of all tap and appurtenant facilities necessary to permit delivery of gas to and receipt of gas from the New Blanco Plant or, alternatively, find that such facilities can be constructed under its "blanket-type" certificate to the extent the require-

ments of 18 CFR § 157.208 are satisfied; (b) modify the existing certificates of El Paso to permit El Paso to modify facilities required to make connections and deliveries to and from the New Blanco Plant in accordance with the obligations of El Paso under the Gas Plant Straddle and Processing Agreement; and (c) approve, to the extent required under Section 7(b) of the Natural Gas Act, the idling or shut down of the reciprocating compressors at the existing Blanco Plant. The suspension of operations at the existing Blanco Plant described above does not raise any Section 7(b) issues inasmuch as such plant has not been certificated and is not jurisdictional under the Natural Gas Act. Should the Commission conclude otherwise, then El Paso requests approval to the extent required under Section 7(b) of the Natural Gas Act to effect suspension of such operations at the existing Blanco Plant.

E. *Accounting Entries*

As reflected in the attached schedule, upon commencement of operations of the New Blanco Plant, El Paso proposes to adjust its records to reflect the cessation of certain operations at the existing Blanco plant by El Paso as previously described. Additionally, upon reconveyance of the leases to Tenneco Oil and Conoco, El Paso proposes to adjust amounts from its book and accounts to reflect the transfer to Tenneco Oil and Conoco of El Paso's interest in the assigned properties and all related equipment required for the production and delivery to El Paso of the gas subject to reconveyance. Accordingly, El Paso respectfully requests that the Commission approve these accounting entries, subject to audit in El Paso's next general rate increase filing pursuant to Section 4 of the Natural Gas Act.

F. *Refunds*

Pursuant to Article VI of the Stipulation, Tenneco Oil and Conoco each shall refund to El Paso, within 30

days of issuance of final and nonappealable orders approving this Offer of Settlement, a sum of $25,000,000, for a total of $50,000,000, in settlement of all past, present and future claims against Tenneco Oil and Conoco arising out of or in any way connected with the issues raised in these docketed proceedings. El Paso, Tenneco Oil and Conoco respectfully request that the Commission find that payment of such refunds to El Paso, and the flow-through of such refunds by El Paso to its jurisdictional customers under the terms of its prior rate settlement agreements, represents a full and complete settlement in liquidation of any and all amounts of refunds by El Paso, Tenneco Oil and Conoco, or any of them, in these, or any future, proceedings arising out of the issues resolved by this Settlement and the Operative Agreements.

G. *Other*

Applicants respectfully request any other approvals or findings as may be necessary under the Natural Gas Act and NGPA to effectuate this Offer of Settlement (including the Settlement and Operative Agreements) and a waiver of any applicable Commission regulations under both the Natural Gas Act and NGPA as may be necessary for issuance of such approvals and findings.

Applicants request that the Commission direct the Solicitor to request the Solicitor General of the United States to file a suggestion of mootness as to Tenneco Oil and Conoco in those cases currently pending before the United States Supreme Court in Nos. 83-1321, -1432, -1433, -1442, -1443 and -1618 at such time as the Commission's order approving the Settlement becomes final and no longer subject to judicial review.

V.

ADDITIONAL REPRESENTATIONS

El Paso, Tenneco Oil and Conoco represent and stipulate that this Offer of Settlement, together with the doc-

uments attached hereto, constitutes the complete agreement among them and that there are no agreements, undertakings or conditions, express or implied, related to the settlement of this proceeding other than those described hereinabove or set forth in the attached Settlement and the related agreements and documents annexed thereto and expressly incorporated therein.

VI.

RESERVATIONS

This Offer of Settlement, which for all purposes shall include the attached Settlement and the Operative Agreements attached thereto, is submitted pursuant to Rule 602 of the Commission's Rules of Practice and Procedure. Unless the attached Settlement shall have become effective in accordance with its terms, this Offer of Settlement shall be privileged and neither its contents nor the contents of any written or oral statements made or prepared in connection with its preparation or negotiation may be used in this or any other pending or future proceeding before this or any other Commission, agency or court.

This Offer of Settlement represents a negotiated settlement with respect to the various matters agreed to herein and is intended to relate only to the specific matters referred to herein. Should this Offer of Settlement be approved, neither El Paso, Tenneco Oil, Conoco, nor any other party or the Commission and its Staff shall be deemed to have approved, accepted, agreed to or consented to any concept, method, theory, principle or statutory interpretation underlying or supposed to underlie any of the matters agreed to herein.

Should this Offer of Settlement not be approved, then all rights, claims and obligations, both procedural and substantive, of El Paso, Tenneco Oil, Conoco, any other party and the Commission and its Staff, as they existed

immediately prior to the submission of this Offer of Settlement, shall be preserved. By consenting to this Offer of Settlement, no party waives any right, claim or objection which it may otherwise have in connection with any matter not expressly provided for herein.

In the event of any inconsistency between this Offer of Settlement (excluding its attachments), on the one hand, and the attached Settlement (including the agreements and documents incorporated therein), on the other, the provisions of the Settlement and the Operative Agreements shall govern.

VII.

DISMISSAL OF TENNECO AND CONOCO AS RESPONDENTS AND TERMINATION OF PROCEEDINGS

Upon the effectiveness of the attached Settlement, Tenneco Oil and Conoco shall be deemed to be dismissed as respondents in *El Paso Natural Gas Company*, et al., Docket No. CP74-314, *et al.*, and *El Paso Natural Gas Company*, Docket No. CI83-356, and the proceedings at *Tenneco Oil Co.*, Docket No. CI84-49, and *CONOCO, Inc.*, Docket No. CI84-50, shall be deemed terminated.

CONCLUSION

El Paso, Tenneco Oil and Conoco respectfully request that the Commission accept this Offer of Settlement as full, fair and final resolution in the public interest of the captioned proceedings as to Tenneco Oil and Conoco and that it promptly issue the attached order approving the Stipulation of Settlement and Agreement without condition or modification.

Respectfully submitted,

EL PASO NATURAL GAS COMPANY

By /s/ Charles R. Jack
CHARLES R. JACK

TENNECO OIL COMPANY and
CONOCO INC.

By /s/ Charles M. Darling, IV
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Attorneys for
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Conoco Inc.

DATED: May 9th, 1984

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused a copy of the attached "Offer of Settlement and Joint Request for Approval of Stipulation of Settlement and Agreement" to be served upon each person on the official restricted service list compiled by the Secretary in this proceeding in accordance with the requirements of Section 2010 of the Commission's Rules of Practice and Procedure.

Dated at El Paso, Texas, this 18th day of May, 1984.

/s/ Arthur R. Formanek
ARTHUR R. FORMANEK

Nos. 83-1321, 83-1432, 83-1433,
83-1442, 83-1443, 83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

JOINT SUPPLEMENTAL BRIEF OF PETITIONER EL PASO NATURAL GAS COMPANY AND RESPONDENTS TENNECO OIL COMPANY AND CONOCO INC.

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May 30, 1984

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

NOS. 83-1321, 83-1432, 83-1433,
83-1442, 83-1443, 83-1618

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

---

JOINT SUPPLEMENTAL BRIEF OF PETITIONER EL PASO NATURAL GAS COMPANY AND RESPONDENTS TENNECO OIL COMPANY AND CONOCO INC.

El Paso Natural Gas Company ("El Paso"), Petitioner in Cause No. 83-1442 above, and Tenneco Oil Company ("Tenneco Oil") and Conoco Inc. ("Conoco"), Respondents in all of the above-referenced causes, jointly file this Supplemental Brief pursuant to Sup. Ct. R. 22.6, in order to disclose that a comprehensive settlement agreement has been entered into between El Paso and Tenneco Oil and Conoco. On May 18, 1984, an "Offer of Settlement and Joint Request for Approval of Stipulation of Settlement and Agreement" was filed by these parties with the Federal Energy Regulatory Commission ("FERC"). The

settlement agreement reached between El Paso and Tenneco Oil and Conoco, if approved by the FERC and other responsible governmental agencies, constitutes a full and final settlement of all proceedings involving the gas lease agreements covering nearly seventy per cent (70%) of the volumes of gas produced by El Paso that is involved in the cases referenced above.

El Paso, Tenneco Oil and Conoco did not previously inform the Court of the filing of this Offer of Settlement with the FERC because the FERC has not reviewed or acted upon any aspect of the Offer of Settlement. These parties wish to advise the Court of the settlement since it is mentioned in the Reply Memorandum filed by the FERC.

Respectfully submitted,

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Counsel for Respondents
Tenneco Oil Company and
Conoco Inc.

May 30, 1984

Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443 and 83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

NORTHWEST PIPELINE CORPORATION, *et al.*,
Petitioners,

v.

PHILLIPS PETROLEUM COMPANY, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF IN OPPOSITION OF THE PLA RESPONDENTS

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May 11, 1984

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether, under section 1(b) of the Natural Gas Act, there is a "sale in interstate commerce of natural gas for resale" when leases covering potential gas-bearing lands are transferred to an interstate natural gas pipeline for the purpose of the pipeline's exploration, development and operation of the properties and

(i) no cash consideration is paid at the time of transfer for any natural gas underlying such leases, on the basis of agreed-upon reserve estimates or otherwise, and

(ii) the lease acreage is not substantially developed by drilling.

LIST OF CORPORATE PARENTS, SUBSIDIARIES AND AFFILIATES

AMOCO PRODUCTION COMPANY

Amoco Production Company is a wholly owned subsidiary of Standard Oil Company (Indiana).

The subsidiaries and affiliates (not wholly owned by Standard Oil Company (Indiana) or a wholly owned subsidiary) of Amoco Production Company are:

Amoco Australia Limited
Amoco Canada Petroleum Company, Ltd.
Amoco Credit Corporation
Amoco Oil Holdings S.A.
Amoco (U.K.) Exploration Company
Analog Devices Inc.
Cetus Corporation
Cyprus Mines Corporation

ATLANTIC RICHFIELD COMPANY

The subsidiaries and affiliates of Atlantic Richfield Company are:

Alpart Farms (Jamaica) Ltd.
Alumina Contractors Limited
Alumina Partners of Jamaica
Alyeska Pipeline Service Company
The Ambler Mining Company
Anaconda Exploration New Zealand Limited
Anaconda Holdings Do Brasil LTDA
Anaflex S.A. de C.V.
Anamax Mining Company
ARCO Australia Coal Pty. Ltd.
ARCO Solar Nigeria Ltd.
Arilan, S.A. de C.V.
Arpet Petroleum Limited
A/S Skaland Grafitiverk
Atlantic Richfield de Mexico, S.A. de C.V.

Aughinish Alumina Limited
Aughinish Estates Limited
Aughinish Finance Limited
Aughinish Property (Nominees) Limited
Badger Pipeline Company
Bingham Development Company
Black Lake Pipe Line Company
Blair Athol Coal Pty., Limited
The British American Metals Company, Limited
Candel International Limited
Caribou-Chaleur Bay Mines Ltd.
Caribou-Smith Mines Ltd.
Centroamericana de Cobre, S.A.
Chile Copper Company
Cobre de Hercules, S.A.
Cobre de Mexico, S.A.
Cobrecel, S.A. de C.V.
Colonial Pipeline Company
Compania de Petroleo Ganso Azul, Ltda.
Compania Minera Dos Republicas, S.A. de C.V.
Compania Minera Kappa, S.A.
Compania Minera Penacobre, S.A.
Cook Inlet Pipe Line Company
Cupro San Louis, S.A. de C.V.
Curragh Coal Sales
Delaware Bay Transportation Company
Dexter de Mexico, S.A.
Dixie Pipeline Company
East Texas Salt Water Disposal Co.
85819 Canada Limited
Eisenhower Mining Company
Empresa de Comercio Exterior Mexicano, S.A. de C.V.
Energy Transportation Systems, Inc.
Ericsson, Inc.
Flower Street Limited
F.T.L. Company Limited
Gravity Adjustment, Inc.

Greater Pacific Limited
Griffith-Consumers Company
Hardy Oil Company
Imperial Eastman de Mexico, S.A.
Impulsora De Cobre, S.A. de C.V.
Industrias Nacobre, S.A. de C.V.
Industrias Tecnos, S.A. de C.V.
Iricon Agency Ltd.
Jamaica Alumina Security Company, Ltd.
Kenai Pipe Line Company
Kronos, Computacion y Teleproceso, S.A. de C.V.
Kuparuk Transportation Capital Corporation
Kuparuk Transportation Company
Las Quintas Serenas Water Company
Lavan Petroleum Co.
Lingobronce, S.A.
Manguera Flex, S.A. de C.V.
Manufacturera Mexicana De Partes Para
Automoviles, S.A. de C.V.
Mayflower Mining Company
R.W. Miller (Holdings) Limited
Minera Anaconda Limitada
Montoro, Empresa Para La Industria Quimica
Nacional de Cobre, S.A.
New Bingham Mary Mining Company
Nihon Oxirane Company, Ltd.
Nordisk Mineselskab A/S
Oil Shippers Service, Inc.
P.T. Arutmin Indonesia
Park City Ventures
Park Cummings Mining Company
Park Premier Mining Company
Participaciones Mexicanas, S.A. de C.V.
Platte Pipe Line Company
Prince Consolidated Mining Company
Productos Especiales Metalicos, S.A.
Richfield U.K. Petroleum, Limited
Rodman, Inc.

The Saudi Cable Company
Servicios Industriales Nacobre, S.A.
Sinclair U.K. Oil Company Limited
Sinclair Venezuelan Oil Company
Smoke House Copper Mining Company
Sociedada Anonima Marvin
Solar Energy Center (E.C.)
Solvamex, S.A. de C.V.
Sumiarco Company Limited
Swecomex, S.A.
Tecumseh Pipe Line Company
Texas-New Mexico Pipe Line Company
Trans Mountain Oil Pipe Line Company
Tubos Flexibles, S.A.
Union de Credito Industrial Vallejo, S.A.
United Park City Mines Company
The Walworth Company
West Mayflower Mining Company
William Prym de Mexico, S.A.

GETTY OIL COMPANY

The stock of Getty Oil Company has been acquired by Texaco Inc.

Getty Oil Company has no subsidiaries and affiliates which are not wholly owned whose securities are publicly traded in the United States or Canada.

The subsidiaries and affiliates (not wholly owned) of Texaco Inc., as reported in the petition for writ in No. 83-1171, are:

Caltex Australia Limited
Duetsche Texaco Aktiengesellschaft, S.I.A.M.
Koa Oil Company
Korea Tanker Company Limited
Texaco Canada Inc.
Texaco Ghana Limited

Texaco Mexicana, S.A. de C.V.
Texaco Nigeria Limited
Texaco Togo
The Great Eastern Oil & Import Co. Limited

MOBIL OIL CORPORATION

Mobil Oil Corporation is a wholly owned subsidiary of Mobil Corporation.

The subsidiaries and affiliates of Mobil Oil Corporation or Mobil Corporation, whose securities are available for purchase by United States citizens, are:

Marcor Inc.
Mobil Alaska Pipeline Company
Montgomery Ward & Co., Incorporated
Montgomery Ward Credit Corporation
Toa Nenryo Kogyo Kabushiki Kaisha

PHILLIPS PETROLEUM COMPANY

The subsidiaries and affiliates of Phillips Petroleum Company are:

Acurex Corporation
Arctic LNG Transportation Company
Bruin Carbon Dioxide Corporation
Calatrava, Empresa para la Industria Petroquimica, S.A.
Canyon Reef Carriers
Cochin Refineries Limited
East Texas Salt Water Disposal Company
Heat Transfer Research, Inc.
Kenai LNG Corporation
Oil Insurance Limited
Papago Chemicals, Inc.
Phillips Carbon Black Limited
Phillips Gas Supply Corporation
Phillips Pacific Chemical Company
Plasticos Vanguardia, S.A.

Polar LNG Shipping Corporation
The Salk Institute Biotechnology
White River Shale Oil Corporation
Aero Oil Company
Canada Western Cordage Company Limited
Chisholm Pipeline Company
Norsea Gas A/S
Phillips Carbon Black Company (Proprietary) Limited
Phillips Carbon Black Italiana S.p.A.
Phillips Petroleum Singapore Chemicals (Private) Limited
Everglades Pipe Line Company
Explorer Pipeline Company
Kaw Pipe Line Company
Nordisk Kemi AB
Nordisk Philblack AB
Norland GmbH Fur Grundbesitz Und Industrieanlagen
Norpipe Petroleum UK Limited
Norsea Gas GambH
Quimica Venoco C.A.
Renalit—Fertighaus GmbH
Seadock, Inc.
Seaway Pipeline, Inc.
Spodco-USA, Inc.
Texas Offshore Port, Inc.
Venezoil, C.A.
Western Desert Operating Petroleum Company
Colonial Pipeline Company
Compagnie Francaise Du Carbon Black
Dixie Pipeline Company
Drisco, S.A. de C.V.
Industrias Negromex, S.A. de C.V.
Petrochim
Spodco Limited
Trenwick Limited
Great Yarmouth Port Labour Company Limited

Norsea Pipeline Limited
Phillips-Imperial Petroleum Limited
(owned by Subsidiary of Phillips Petroleum
Company United Kingdom Limited)
Philmac Oils Limited
Philmac Panama Incorporated
Sevalco (Holdings) Limited
Iranian Marine International Oil Company
("Iminoco")
Alyeska Pipeline Service Company
Insurance & Reinsurance Brokers (Bermuda)
Limited
Norpipe a.s.

T.H. McELVAIN OIL AND GAS PROPERTIES, *et al.*

None of the parties to PLA-4 (T.H. McElvain Oil and Gas Properties, *et al.*) is a corporation. The list of the parties to PLA-4 which appears in the various Petitions for Certiorari should be corrected to read as follows:

T. H. McElvain Oil and Gas Properties
Grace M. Brown
Catherine B. McElvain
T. H. McElvain, Jr.
Catherine M. Harvey
James E. McElvain, Executor of Estate of
Carl R. McElvain
Nancy Ridgely
Brenda V. Petke
James M. Raymond, as Trustee of Estate of
F.B. Miller
Corrine Miller Gay Trust
Maydell Miller Mast Trust
Maybelle Miller Nestler Trust
Ruth M. Vaughn

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443 and 83-1618

NORTHWEST PIPELINE CORPORATION, *et al.*,
Petitioners,

v.

PHILLIPS PETROLEUM COMPANY, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF IN OPPOSITION OF THE PLA RESPONDENTS

Respondents Amoco Production Company, Atlantic Richfield Company, Getty Oil Company, Mobil Oil Corporation, Phillips Petroleum Company, and T.H. McElvain Oil and Gas Properties, *et al.* ("the PLA respondents") respectfully request that this Court deny the petitions for writ of certiorari seeking review of the judgment of the United States Court of Appeals for the Fifth Circuit in this case.[1]

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[1] Petitions for a writ of certiorari have been filed by the People of the State of California, *et al.* ("California") (No. 83-1321); the Public Utility Commissioner of Oregon, *et al.* ("Oregon") (No. 83-1432); Northwest Pipeline Corporation, *et al.* ("Northwest") (No. 83-1433); El Paso Natural Gas Company ("El Paso") (No. 83-1442); Pacific Gas and Electric Company, *et al.* ("PG&E") (No. 83-1443); and the Federal Energy Regulatory Commission ("FERC") (No. 83-1618). Citations to the various petitions will be in the form "California Pet. at ——." The Appendix prepared by California will be cited as "Pet. App. at ——." A complete listing of all the parties to this case appears in the FERC Pet. at ii to xi.

STATEMENT OF THE CASE

A. Background of the Litigation

This case involves a series of agreements entered into in the 1950s by El Paso Natural Gas Company and Pacific Northwest Pipeline Corporation [2] with the holders of lease rights to possible gas-bearing lands in the San Juan Basin area of New Mexico and Colorado.[3] Under the agreements, the leaseholders conveyed to El Paso and Pacific Northwest the right to explore for and produce gas from certain geological formations underlying the leasehold acreage. In exchange, the leaseholders retained an overriding royalty on all gas produced by the pipelines from these leases. The overriding royalty in each agreement was stated in terms of cents per thousand cubic feet of gas, subject to escalation and possible redetermination at stated intervals of time. The agreements provided that the leaseholders were not to be involved in exploration or production; all such operations were to be performed by or on behalf of the pipelines. *See* Pet. App. at 126a-127a.

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[2] After the agreements were made and implemented, El Paso acquired Pacific Northwest. Subsequently, El Paso was ordered by this Court to divest its acquisition, *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 662 (1964); *see also Utah Public Service Commission v. El Paso Natural Gas Co.*, 395 U.S. 464 (1969); *Cascade Natural Gas Corp. v. El Paso Natural Gas Co.*, 386 U.S. 129 (1967), resulting in the creation of the present Northwest Pipeline Corporation in February 1974. The agreements originally made by Pacific Northwest, known as Pacific Lease Agreements (PLAs), were transferred to Northwest Pipeline at divestiture. The essentially identical agreements retained by El Paso are called Gas Lease Agreements (GLAs). *See* Pet. App. at 38a.

[3] These leaseholders (or their successors), which include both corporations and a large number of individuals, are the respondents in the present case. The parties sponsoring this Brief are denominated the PLA respondents because they have PLA agreements with Northwest. *See* note 2 *supra*. One of the PLA respondents, Atlantic Richfield Company, also has a GLA agreement with El Paso and therefore is a signatory of the separate Brief in Opposition of Respondents Tenneco Oil Company, *et al.*

From their inception, these agreements were treated by all concerned, including the Federal Power Commission,[4] as nonjurisdictional lease transactions, rather than sales in interstate commerce of natural gas for resale. In every pipeline rate case from the mid-1950s until this litigation was begun, the Commission reviewed and allowed in the pipelines' cost-of-service the overriding royalties paid by El Paso and Northwest. The Commission's lack of jurisdiction over the lease sales was never questioned in any of those cases.[5]

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[4] Both the Federal Power Commission and its successor the Federal Energy Regulatory Commission will be referred to herein as "the Commission."

[5] In fact, the Commission's treatment of the lease sales as nonjurisdictional went beyond mere passive acquiescence. In *Phillips Petroleum Co.*, Opinion No. 338, 24 F.P.C. 537 (1960), *rehearing denied*, 24 F.P.C. 1008 (1960), *aff'd*, *Wisconsin v. FPC*, 303 F.2d 380 (D.C. Cir. 1961), *aff'd*, 373 U.S. 294 (1963), the first independent producer rate case at the FPC, the Commission carefully separated Phillips' jurisdictional costs for its wellhead sales of gas from its nonjurisdictional costs associated with its royalty interests, including primarily the San Juan Basin overriding royalties. *See* 24 F.P.C. at 557, 565; *see also id.* at 664-66 (hearing examiner's discussion of nonjurisdictional status of exploration costs relating to Phillips' PLA agreement). As late as 1973, the Commission expressly reaffirmed that these agreements were not the equivalent of jurisdictional sales of gas. *William G. Webb*, Opinion No. 642, 49 F.P.C. 17 (1973). Distinguishing the "Webb-Turner" lease-sale agreements, which are among those now before this Court, from the agreements held jurisdictional by this Court in *United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965) ("*Rayne Field*"), the Commission held that the San Juan Basin agreements:

> represented a method evolved by El Paso and the Producers to cause the exploration for and the development of necessary gas supplies . . . . The transactions arose out of the needs of the parties rather than being almost wholly a rearrangement of payments, as in *Rayne*, to accomplish the same result as a conventional sale.

49 F.P.C. at 26.

B. The District Court Proceeding

In 1973, the overriding royalty under one of the agreements was increased substantially as the result of arbitration pursuant to the redetermination provision in the agreement. In reaction, El Paso filed a complaint in district court, alleging for the first time[6] that these transactions were subject to Commission jurisdiction as "sales of gas" under the Natural Gas Act.[7] Subsequently, El Paso and Northwest both filed complaints with the Commission, raising the same claim. The Commission, at the urging of its staff, refused to act on the complaints,[8] choosing instead to defer to the district court. *See* Pet. App. at 37a & n.7.[9]

In January 1977, following a lengthy trial, the district court ruled that these transactions were not jurisdictional under the Natural Gas Act. Pet. App. at 121a. Applying the principles of *Rayne Field*, *see* note 5 *supra*, the district court rested its decision on three major factors: (1) the absence of proven reserves at the time the agreements were made; (2) the lack of substantial development of the properties at that time; and (3) the fact that the lease sales were not the economic equivalent of conventional gas sales but were unique transactions formulated to meet the needs of the parties. *Id.* at 131a-133a.

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[6] In the *Webb* case, *see* note 5 *supra*, El Paso had urged the Commission to hold the lease sales nonjurisdictional.

[7] After the divestiture of Northwest by El Paso, *see* note 2 *supra*, Northwest joined the suit as a plaintiff.

[8] Significantly, the Commission staff took the position at the time that, if the Commission were to address the issue of jurisdiction, it should find the San Juan Basin lease sales nonjurisdictional. *See* Docket No. CP74-314, Staff's Comments to Complaint of El Paso Natural Gas Company and Request for an Order to Show Cause at 4-8 (July 19, 1974). The relevant portion of the staff's 1974 analysis of this issue is set forth in the Appendix to this Brief.

[9] Subsequently, El Paso and Northwest entered into interim settlements with the GLA and PLA royalty owners regarding the level of overriding royalties.

The court began its analysis by examining the agreements made with El Paso. On the issue of proven reserves, the court found that "[t]he GLAs in issue were not transfers of leases with proven reserves, since no reasonable estimate of recoverable reserves underlying the specific acreage conveyed could be made at the time [each] respective GLA was executed." *Id.* at 131a. With respect to substantial development, the court likewise determined that the GLA acreage fell short of meeting the jurisdictional test. "Where wells had been drilled," the court observed, "the number was exceptionally low compared to the number of available drilling sites. Wells in the Basin generally were incapable of recovering commercially significant amounts of gas." *Id.* at 132a. Moreover, the court found, "[t]he GLAs themselves indicate that the parties negotiated for undeveloped acreage. . . . Each transaction made sense economically, only if undeveloped acreage were transferred. . . ." *Id.* at 133a.

Regarding the final factor, economic equivalency to conventional sales, the court found the San Juan Basin lease sales distinguishable from the transactions held jurisdictional by this Court in *Rayne Field.* "The parties did not enter into the GLAs as a means of shifting payments as in *Rayne Field,*" the court commented.[10] "Rather, these agreements arose from the unique economic situation of the parties and reflected their efforts to structure the transactions so that El Paso would explore for and de-

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[10] The district court rejected the assertion—advanced here by nearly all the petitioners—that the events concerning the Barker Dome Field, which preceded the transactions here at issue, evidenced an intent of the parties to the GLAs and PLAs to evade Commission jurisdiction. *See, e.g.,* El Paso Pet. at 4-6; FERC Pet. at 4-5. "[T]he history of the Barker Dome agreement is not analogous to the agreements here at issue," the court said. "The negotiations surrounding Barker Dome reflect El Paso's efforts to enter the San Juan Basin. Once El Paso was certified, it held a virtual monopsony in the Basin . . . ." Pet. App. at 125a n.5.

velop gas reserves in the Basin." *Id.*[11] The court made virtually identical findings with regard to PLA-13, the only Northwest agreement then at issue. *Id.* at 133a-134a.

Based on these findings, the district court concluded that the lease transactions were nonjurisdictional. "Because no agreement was the economic equivalent of a gas sale contract," the court stated, "and because the leases transferred were neither proven nor substantially developed at the time of the execution of those agreements, each agreement at issue in this litigation . . . is not a 'sale in interstate commerce of natural gas for resale' . . . ." *Id.* at 134a-135a.

C. The Commission Proceeding

After the district court issued its decision, the Commission instituted a show-cause proceeding to reconsider the question of its jurisdiction over the San Juan Basin lease sales.[12] A Commission administrative law judge reheard the issues raised in the district court and entered an initial decision contrary to the district court's opinion.

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[11] The district court explained that El Paso, which was regulated on a cost-of-service basis, could afford to explore for and produce gas in an area such as the San Juan Basin, while independent producers, who were limited by the price the pipeline was willing to pay, could not. Pet. App. at 128a n.13. The district court attributed the format of the lease sales to these economic circumstances and not to any intent to escape Commission regulation.

[12] Respondents filed a petition for review challenging the institution of the Commission proceeding on res judicata and collateral estoppel grounds. Without reaching the issues presented, the Fifth Circuit directed the Commission to proceed, and deferred action on the pipelines' appeal of the district court decision pending receipt of the Commission's opinion. Pet. App. at 137a. Because the Fifth Circuit ultimately decided the jurisdictional issue on the merits, it never reached the collateral estoppel and res judicata issues. Pet. App. at 19a.

The administrative law judge concluded that the lease-sale transactions were the economic equivalent of conventional gas sales and were therefore subject to the Commission's jurisdiction. Pet. App. at 33a-120a.

On September 25, 1980, the Commission reversed its stance of almost thirty years and adopted the initial decision as its own opinion.[13] Following the denial of rehearing, petitions for review of the Commission decision were filed and consolidated with the pipelines' pending appeal from the district court decision.

D. The Court of Appeals Decision

The court of appeals unanimously affirmed the district court's conclusion that these transactions were not jurisdictional, and reversed the Commission's contrary conclusion. It started with an examination of this Court's decision in *Rayne Field*, which it termed the "fountainhead decision setting forth the factors to apply in determining whether a transaction is jurisdictional." Pet. App. at 11a. In *Rayne Field*, the Fifth Circuit explained, the Supreme Court "directed a case-by-case analysis of hybrid lease-sale arrangements, the fundamental inquiry being whether 'the sales of these leases in . . . a proven and substantially developed field . . . accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other states.'" *Id.* at 12a, quoting 381 U.S. at 401. Relying on its decision in *Continental Oil Co. v. FPC*, 370 F.2d 57 (5th Cir. 1966), *cert. denied*, 388 U.S. 910 (1967) (*"Ship Shoal"*), the court of appeals found three factors to be relevant to the *Rayne Field* determination: (1) whether "the economic effect of the transfer [is] similar to that of a conventional sale"; (2) whether "the subject of the transaction [is] 'proven and substan-

[13] In its order, the Commission initiated a remedy proceeding to determine whether any refunds were due as a result of its jurisdictional finding, the amount of any such refunds, and the level of future overriding royalties. The remedy proceeding was suspended immediately following the Fifth Circuit's decision.

tially developed' reserves"; and (3) whether "the transfer of the reserves [is] for [the] purpose of interstate transmission and resale." Pet. App. at 12a, quoting 370 F.2d at 62.[14]

Applying this test to the facts at hand, the court of appeals discerned a fundamental error in the Commission's approach to the jurisdictional issue. "In determining whether a transfer is jurisdictional under the [Natural Gas] Act," the court stated, "*Ship Shoal* teaches that all three of the above factors must be present. The administrative law judge and the Commission, however, elevated the first prong—economic equivalency—from a component in the *Rayne Field* test to the determinative factor on the issue." Pet. App. at 12a-13a. "Carried to its logical conclusion," the court reasoned, "the Commission's economic equivalency/commercial realities approach could render any sale of lease rights to an interstate pipeline company jurisdictional merely because the transaction ultimately results in successful production and disposition of gas in interstate commerce." *Id.* at 14a.

Because its opinion focused on this critical flaw in the Commission's reasoning, the Fifth Circuit had no occasion to address two of the district court's principal findings, namely, that the lease-sale agreements were not economically equivalent to conventional gas sales and that they did not constitute transfers of proven reserves.[15] Instead, the court of appeals affirmed the result reached

[14] The court further noted that, under *Ship Shoal*, the "proven and substantially developed" test has two aspects: "(1) definability of gas volume based upon proof of reserves and (2) imminent ability to produce in commercial quantities." Pet. App. at 12a, citing 370 F.2d at 63-64.

[15] While the court of appeals did comment in passing that "the reserves in the Basin may well have been 'proven' at least within reasonable estimates," *id.* at 15a, the court did not address the question directly, nor did it overturn the district court's finding that the reserve estimates at the time covered the entire San Juan Basin, leaving the volume of reserves underlying particular tracts highly uncertain. *See id.* at 131a n.19.

by the district court solely on the ground that "the lease-sale agreements did not involve substantially developed reserves, and the Commission erred in determining [that they] did." *Id.* at 15a. Expressly adopting the district court's finding that "actual drilling is the only method of definitely locating recoverable gas saturations [in the San Juan Basin]," *id.* at 9a, the Fifth Circuit found the "limited extent to which the Basin had been drilled at the time the GLAs and PLAs were executed" an "important factor" in evaluating whether the agreements were jurisdictional, *id.* at 15a. "While the number of wells existing at execution of the agreement is not the *sine qua non* of substantial development," the court stated, "the Commission has considered this factor, and the cases point up its significance." *Id.* at 16a, citing *Rayne Field* and *Texas Gas Transmission Corp.*, 3 FERC ¶ 61,135 (1978). Since the evidence below revealed that "the few wells in the ground when the agreements were executed could not have come close to depleting the acreage," Pet. App. at 16a,[16] the court of appeals concluded that "the acreage was not substantially developed [and] the agreements in issue were not sales of gas under the Natural Gas Act," *id.* at 17.

Petitioners sought rehearing and rehearing *en banc* of the unanimous decision of the Fifth Circuit panel. Despite petitioners' vigorous assertions of an intracircuit conflict (which they have renewed here), the requests for rehearing and rehearing *en banc* were denied on December 2, 1983, without having attracted any votes. Pet. App. at 152a. Petitions for a writ of certiorari were subsequently filed by six separate parties or groups of parties. *See* note 1 *supra*.

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[16] In fact, the court noted, a number of the agreements covered acreage on which no wells existed at the time of execution. The Phillips PLA, for example, involved 188,000 acres which did not contain a single well. *Id.* at 16a. By 1977, 365 wells had been drilled on this acreage, *id.*, and the number has increased substantially since then.

SUMMARY OF ARGUMENT

It is well-established that while the Natural Gas Act vested the Commission with jurisdiction over wellhead sales of gas in interstate commerce, transfers of gas leases are normally outside the Commission's jurisdiction. *Compare, e.g., Phillips Petroleum Co. v. Wisconsin,* 347 U.S. 672 (1954), *with Mobil Oil Corp. v. FPC,* 463 F.2d 256 (D.C. Cir. 1971), *cert. denied,* 406 U.S. 976 (1972). An exception is made when the conveyance of a gas lease in a "proven and substantially developed field" transfers an agreed-upon volume of gas reserves in place. When such a transaction is the functional equivalent of a wellhead sale of gas, this Court has held that it can constitute a jurisdictional sale. *Rayne Field,* 381 U.S. at 401.

Applying the *Rayne Field* standard, the courts below held that the lease-sale transactions at issue here were not sales of gas under the Natural Gas Act. Contrary to petitioners' assertions, this decision does not present an issue of broad legal significance, nor does it threaten to undercut Commission jurisdiction or to inflict significant financial harm on gas consumers.

The Fifth Circuit's decision is fully consistent with other cases in this well-defined field of law and plainly does not alter the jurisdictional standard established by this Court in *Rayne Field.* Petitioners have not advanced any persuasive argument to justify abandonment of the *Rayne Field* test. Their proposal to delete the "proven and substantially developed" element from the jurisdictional standard disregards the express statutory limitations on Commission jurisdiction and ignores the key role this requirement plays in the determination whether what is sold is gas, or merely the right to find and produce gas. Indeed, the Commission itself has recognized that, in the absence of substantial development, no "sale of gas" within the meaning of the Natural Gas Act is possible. *See Texas Gas Transmission Corp.,* 3 FERC ¶ 61,135 (1978).

In addition, the unique circumstances presented here, together with recent developments in the field of natural gas regulation, strongly indicate that this case is now *sui generis*. This Court's decision that the first-sale provisions of the Natural Gas Policy Act of 1978 ("NGPA"), Pub. L. No. 95-621, 92 Stat. 3350, 15 U.S.C. §§ 3301 *et seq.*, apply to pipeline-produced gas, *Public Service Commission v. Mid-Louisiana Gas Co.*, 103 S. Ct. 3024 (1983), makes it highly unlikely, for practical reasons, that the issue raised here will ever recur. Furthermore, even if this issue were to arise again, the enactment of the NGPA has substantially altered the statutory scheme under which it would be decided. There is thus no need for this Court to make elaborate refinements on the jurisdictional standard applicable under the Natural Gas Act, nor is there any prospect that an "attractive gap" will be opened in the regulatory scheme.

Petitioners contend that, unless overturned, the decision below will cause serious financial harm to gas consumers on the West Coast. To the contrary, there is no significant prospect that the decision will increase the future cost of gas to consumers. Nothing in the decision below affects the Commission's longstanding jurisdiction to control the rates the pipelines charge their customers. Moreover, absent extraordinary Commission action, consumers cannot be required to pay more for this gas than the applicable NGPA ceiling prices, regardless of the outcome of this case. Given additionally that the prospect of retroactive refunds in this case is at best highly speculative, the claim that the public will suffer if the decision below is not reversed must be viewed with great skepticism.

In summary, the decision below has little precedential significance. It will not affect the scope of Commission jurisdiction in the future, nor does it open any gap in the regulatory scheme. Its impact, either prospective or retroactive, on the gas-consuming public is minimal. For these reasons, review by this Court is both unnecessary and unwarranted. The petitions for certiorari should therefore be denied.

REASONS FOR DENYING THE WRIT

I. PETITIONERS HAVE PRESENTED NO SIGNIFICANT LEGAL ISSUE WARRANTING THIS COURT'S ATTENTION

The issue in this case is whether, under section 1(b) of the Natural Gas Act, the particular lease-sale transactions involved here are subject to the jurisdiction of the Commission. The courts below, applying the established *Rayne Field* test, held that they are not. Petitioners challenge that determination on two basic grounds: first, that the *Rayne Field* test is wrong and should be revised, and second, that even if *Rayne Field* articulated the proper jurisdictional test, the court below misapplied that test. Neither of these contentions raises an issue worthy of this Court's review.

A. The *Rayne Field* Test, Including the 'Proven and Substantially Developed' Element, Is the Proper Jurisdictional Standard

Petitioners are virtually unanimous in suggesting that this Court should eliminate one of the key elements of the *Rayne Field* test, namely, the requirement that the reserves in question be substantially developed. El Paso's petition states, for example, that "it makes no sense to require that the lease sale acreage be substantially drilled." El Paso Pet. at 14; *see also* California Pet. at 15; Northwest Pet. at 24.[17] Petitioners apparently would prefer a test under which any conveyance of an interest in possible gas-bearing lands would be subject to Commission jurisdiction if the transaction ultimately leads to

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[17] El Paso, like several of its co-petitioners, painstakingly edits out the critical language from the Court's statement in *Rayne Field* that the lease sales there, which involved "*a proven and substantially developed field*, accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States." 381 U.S. at 401 (emphasis added). *Compare* El Paso Pet. at 14; Northwest Pet. at 18; California Pet. at 17 (all omitting the phrase italicized above).

the production of gas for sale in interstate commerce by a natural gas pipeline company.

Contrary to petitioners' assertions, however, the "proven and substantially developed" test is a well-established and essential component of the jurisdictional standard under the Natural Gas Act. *See Rayne Field*, 381 U.S. at 401-03; *Ship Shoal*, 370 F.2d at 62. It is a critical element in distinguishing nonjurisdictional land transactions from jurisdictional sales of natural gas. The function of this test is to determine, precisely as the Commission has stated the issue in its petition, "whether what [is] sold [is] gas or merely the right to explore for gas." FERC Pet. at 19.

The test reflects the elementary fact, accepted everywhere in the industry, that the question whether, and to what extent, gas underlies particular acreage cannot be answered in the absence of actual drilling which penetrates the gas-bearing sands.[18] It is this penetration of productive sands which permits a determination (by core analysis, electric log or other means) of the actual presence of natural gas. Absent such a determination, there plainly cannot be a "sale of gas" over which Congress has given the Commission authority.[19]

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[18] The disclosure regulations of the Securities and Exchange Commission, for example, limit the classification of reserves as "proved" to those areas of a reservoir "delineated by drilling and defined by gas-oil and/or oil-water contacts, if any, and . . . the *immediately adjoining* portions not yet drilled, but which can be reasonably judged as economically productive on the basis of available geological and engineering data." 17 C.F.R. § 210.4-10(a)(2)(i) (1983) (emphasis added). Natural gas "that may occur in undrilled prospects" cannot be classified as "proved reserves." *Id.* § 210.4-10(a)(2)(iii)(C); *see also id.* § 210.4-10(a)(4). The standards for "proved, developed" reserves are even more stringent; only "reserves that can be expected to be recovered through existing wells with existing equipment" can be classified as "proved, developed." *Id.* § 210.4-10(a)(3).

[19] The "proven and substantially developed" test reflects this basic physical fact. The mere presence of geology favorable to the

This Court recognized as much in its landmark decision in *Rayne Field.* First, the Court linked the substantial development of the Rayne Field reserves to the "significant and determinative economic fact" that the lease sales "in Rayne Field, *a proven and substantially developed field,* accomplished the transfer of large amounts of natural gas to an interstate pipeline company." 381 U.S. at 401 (emphasis added). The Court thus acknowledged that the Rayne Field lease sales would not have been sales of *gas* without substantial development which permitted verification of the estimated reserves thought to underlie the acreage.

Second, the *Rayne Field* Court expressly relied on the substantial development of the Rayne Field reserves to distinguish *FPC v. Panhandle Eastern Pipe Line Co.,* 337 U.S. 498 (1949), which had held that sales of undeveloped leases fall within the "production or gathering" exemption of section 1(b). 381 U.S. at 403-04. *Panhandle,* the Court said, did not pose the "present problem—whether the transfer to an interstate pipeline company for transmission and resale in interstate commerce of *proven and substantially developed* gas reserves is subject to Commission jurisdiction." *Id.* at 404 (emphasis added). As the Court explained:

> The substantiality of development is a relevant consideration for the more that must be done before the gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce which . . . the Act has affirmatively placed within Commission jurisdiction.

Id. at 403.[30]

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accumulation of gas does not insure that there is a commercial accumulation, or indeed any accumulation at all. This is attested to by the fact that dry holes are frequently drilled, even in producing fields.

[30] The Commission argues that, while substantial development is "a relevant consideration," it cannot be the dispositive factor in a

The Commission itself has recognized that substantial development is a crucial component of the jurisdictional test. In *Texas Gas Transmission Corp.*, 3 FERC ¶ 61,135 (1978), the Commission held a sale of reserves in place nonjurisdictional on the ground that the reserves were not substantially developed.[21] The issue of the importance of the substantial development test thus does not raise a serious legal question requiring this Court's attention.

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particular case. FERC Pet. at 14-15 (emphasis in original). The import of this distinction is unclear: if the substantiality of development can never affect the outcome of a particular case, it is hard to see how it is relevant. In any event, the Commission's contention that substantial development cannot be viewed as "an essential predicate to jurisdiction," *id.* at 15, is not supported by the evidence cited. The observation, for example, that a sale of natural gas can occur "'before production or gathering is ended,'" *id.*, quoting 381 U.S. at 402, merely indicates that, under certain circumstances, a jurisdictional sale can involve gas that is still in the ground. This principle in no way contradicts the basic *Rayne Field* standard that one of the characteristics defining a jurisdictional sale of gas in place is substantial development through drilling, for the sale of a defined volume of gas in the ground was precisely what *Rayne Field* involved. The same holds for the Commission's observation that the production and gathering exemption relates to the physical process of producing and gathering gas. FERC Pet. at 15, citing 381 U.S. at 402. That truism notwithstanding, substantial development is a logical, firmly grounded prerequisite to the existence of a jurisdictional sale of gas in place.

[21] As the Commission stated:

> Since the [sellers] had not sufficiently developed the field to be able to conduct economically feasible wellhead arrangements, [they] could not have made a conventional wellhead sale to [the buyer] if the parties had so desired. Only 14 wells had been completed, and only 10 of these were productive . . . . Clearly, these are essentially undeveloped reserves requiring further development for feasible production. . . . [I]n our view, the sale of [these] reserves . . . does not constitute a sale for resale in interstate commerce requiring a certificate under Section 7(c) of the Natural Gas Act.

Id. at 61,405-06.

B. The *Rayne Field* Test As Applied Here Does Not Leave an 'Attractive Gap' in the Regulatory Scheme

As shown above, the *Rayne Field* test is the proper standard for judging the jurisdictionality of lease-sale transactions under the Natural Gas Act. Of perhaps equal importance to this Court, the issue of the proper standard under that Act no longer has any real significance beyond the unique facts of this case. Indeed, petitioners have failed to show in any way that the existing *Rayne Field* test leaves an "attractive gap" in the regulatory scheme.

This is so for two major reasons. First, the Natural Gas Act has ceased to be the only statute defining the scope of federal jurisdiction over sales of natural gas. With the enactment of the NGPA in 1978, Congress "comprehensively and dramatically changed the method of pricing natural gas produced in the United States." *Public Service Commission v. Mid-Louisiana Gas Co.*, 103 S. Ct. 3024, 3026 (1983). In particular, while preserving "the Commission's authority under the [Natural Gas Act] to regulate natural gas sales from pipelines to their customers," the NGPA was "designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first sales' of natural gas." 103 S. Ct. at 3031. The NGPA explicitly describes the "first sales" subject to its coverage as including the sale of "proven reserves in place." 15 U.S.C. § 3301(22).[22]

Consequently, even for transactions properly characterized as transfers of gas in place, the judicially devel-

[22] Because this provision applies only to the "transfer of title" to reserves, *id.*, it is inapplicable to the GLA and PLA agreements. Even if those transactions could be found to have involved "proven reserves," *compare* Pet. App. at 131a, the transfer of title under the GLAs and PLAs took place several decades before enactment of the NGPA.

oped jurisdictional test under the Natural Gas Act has been supplemented—if not supplanted—by a newly applicable statutory standard. Further refinements on the jurisdictional principles relevant under the prior statute are therefore of limited utility. Since the Natural Gas Act test established in *Rayne Field* does not control the jurisdictionality of lease sales occurring after November 8, 1978, *see* 15 U.S.C. § 3431(a)(1)(A), the relevance of the decision below is effectively confined to the GLA and PLA agreements here, and to comparable transactions, if any exist, that were consummated before the NGPA took effect.[23]

The second reason that the issue raised here lacks broad significance relates to this Court's recent decision in *Mid-Louisiana*, 103 S. Ct. 3024 (1983). By holding in that case that the NGPA's "first sale" definition includes pipeline-produced gas, the Court ensured that NGPA ceiling prices would be applicable whether particular gas reserves were produced by a pipeline or by an independent producer. As the Commission concedes in its brief, "If

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[23] As a factual matter, lease-sale transactions comparable to those in *Rayne Field* have been a relative rarity in the industry. El Paso, for example, cites five, the most recent of which occurred in the early 1960s. El Paso Pet. at 13 n.14. As the district court's opinion clearly indicates, repetition of the specific type of transaction involved in this case is even more unlikely. *See, e.g.*, Pet. App. at 125a-134a. Unique circumstances existing in the San Juan Basin in the early 1950s gave rise to equally unique transactions. These circumstances included the existence of a potentially large but untapped source of gas; the unusual geology of the Basin; El Paso's need for a reliable gas supply to serve the expanding post-World War II California market; El Paso's dependence at the time on frequently interrupted sources of gas produced from wells that were primarily devoted to oil production; the low ratio of gas prices to oil prices; the market power of the pipelines as sole buyers of gas in the Basin; and the lack of incentive for independent producers to incur the costs of developing the San Juan Basin at then-prevailing wellhead prices as compared to the incentive of the pipelines, which could price their production on a cost-of-service basis.

the lease transactions are deemed to be nonjurisdictional, then under *Mid-Louisiana* the pipelines' sales of their production would be considered first sales within the meaning of the NGPA and the pipelines could charge their customers only the applicable NGPA rate . . . ." FERC Pet. at 21. Since NGPA pricing would also be applicable if the lease sales were found jurisdictional, it is now essentially immaterial to the nation's gas consumers which result obtains. Given that the underlying rationale of both the Natural Gas Act and the NGPA is consumer protection, *see Mid-Louisiana*, 103 S. Ct. at 3042 (White, J., dissenting), the issue of jurisdictionality, at least in the kind of circumstances presented here, has become largely irrelevant.

The Commission suggests that the issue is still alive by pointing out that, if a particular lease transaction is held nonjurisdictional, the pipeline involved may find itself with a royalty obligation in excess of the price it can charge its customers. FERC Pet. at 21.[34] Rather than permitting its stockholders to absorb excess royalty costs, it is asserted, the pipeline might seek to shift the burden onto its customers by requesting special relief from the Commission. *Id.* This contention ignores the critical role of the Commission as a guardian of the public interest. Only the Commission has the authority to permit collection of prices in excess of the NGPA statutory ceilings. *See, e.g.*, 15 U.S.C. § 3314(2); *see also Mid-Louisiana*, 103 S. Ct. at 3032; *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 328 (1974). No pipeline could enter into a lease-sale transaction with any reasonable expectation

[34] This possibility is largely theoretical. Both of the pipelines involved in this case have actively sought NGPA pricing for their gas, including the production from the PLA and GLA acreage. El Paso has estimated that if these lease sales were to be held jurisdictional, it would gain as much as $4.6 billion in added revenues from the application of NGPA pricing, rather than cost-of-service pricing. Even if the lease sales are not jurisdictional, however, El Paso stands to gain only about 17 percent less.

that it would automatically be able to pass through to its customers royalties in excess of NGPA prices. *See FERC v. Pennzoil Producing Co.*, 439 U.S. 508, 517-19 (1979).

As a result, it is very doubtful that the issue presented here will ever arise again. The NGPA controls the price that pipelines may charge for their own production. If a pipeline were to agree to pay royalties in excess of the NGPA ceiling price, that would be a matter to be resolved between the pipeline and the royalty owner. The consumer could not be charged a penny more than the statutory ceiling price without express Commission approval.

C. The Decision Below Is Not in Conflict with Other Decisions

Once petitioners move beyond their contention that the *Rayne Field* test should be reformulated, their attack on the decision below reduces to a claim that the court of appeals deviated from the approach allegedly taken in other cases and misapplied the *Rayne Field* test to the facts presented here. Not only are the claimed conflicts simply nonexistent, but the entire question of the Fifth Circuit's application of the *Rayne Field* test is a highly fact-specific issue unworthy of review by this Court.[28]

The principal conflict asserted by petitioners involves the *Ship Shoal* case, another Fifth Circuit decision applying *Rayne Field*. *Ship Shoal*, however, like *Rayne Field*, and its companion case, *FPC v. Pan American Petroleum Corp.*, 381 U.S. 762 (1965) ("*Bastian Bay*"), is plainly distinguishable. *Ship Shoal* involved a 3,000-acre tract on which some 17 wells had been drilled over a five-year period, including seven oil wells with 17 completions and one gas well with two completions. 370 F.2d at 59-60.

[28] That the issue is essentially factual was acknowledged by El Paso in its Answering Brief in the court below. "While ultimately an issue of law," El Paso contended, "the jurisdictional issue is *fact-intensive*." Answering Brief of El Paso, *et al.*, at 4 (emphasis added).

"Gas was found in 46 reservoirs in 39 distinct sand zones," the court observed. "Later, drilling on five potential gas wells was commenced but completion was deferred." *Id.* at 60.[26] The FPC hearing examiner found that "the Ship Shoal gas had been 'ready for action since 1960.'" *Id.* at 65. Moreover, witnesses for the lease sellers "did not refute the evidence of Ship Shoal's imminent ability to produce gas in commercial quantities." *Id.* Based on findings such as these, the *Ship Shoal* court had no difficulty determining that the field was "proven and substantially developed" under the *Rayne Field* test. *Id.* at 66.

The facts in *Rayne Field* and *Bastian Bay* are similarly illuminating. In *Rayne Field*, 19 of a possible 26 wells had been drilled on the acreage conveyed by the agreement. *See id.* at 64. The Commission considered this a "'fully developed'" field. *Id.*, quoting *Texas Eastern Transmission Corp.*, 21 F.P.C. 860, 861 (1959). In *Bastian Bay*, 32 of a possible 39 wells had been drilled, with 21 oil completions and 20 gas completions. 370 F.2d at 64.

In this case, by contrast, only 42 wells had been drilled on the 375,000 acres conveyed by the PLA lease sales at the time of execution of the respective agreements, an average of less than one well for each 8,900 acres.[27] The

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[26] Petitioners argue that the presence of only one dually-completed gas well on the Ship Shoal acreage indicates that the development of gas there was negligible, and thus that substantial development was not actually required in that case. *See* Northwest Pet. at 21; El Paso Pet. at 15 n.16. This contention overlooks the fact that the existence of gas in numerous reservoirs had been demonstrated by drilling. Indeed, the drilling had enabled the parties to agree upon a definite volume of reserves in place that were purchased for cash at closing—a factor not present in any of the PLAs or GLAs.

[27] Similarly, as the court of appeals noted, GLA-47, the largest El Paso agreement, covered more than 102,000 acres, on which there were only 24 wells at the time of signing of the agreement, approximately one for each 4,250 acres. Pet. App. at 15a-16a. By

largest Northwest agreement, PLA-5, provided a "dramatic example of the lack of substantial development" of the properties. *Id.* "At the time of the agreement," [28] the Fifth Circuit noted, "there were no wells on the 188,000 acres [of PLA-5].[29] By December 1977, however, 365 wells were productive." Pet. App. at 16a. The starkly contrasting fact patterns of these cases belie petitioners' claim that the decision below is in conflict with the *Rayne Field-Bastian Bay-Ship Shoal* trilogy of cases.[30]

1976, more than 700 wells had been drilled on the GLA-47 acreage. *Id.* at 16a.

[28] Northwest argues strenuously that the court of appeals should have judged the substantiality of development of the lease-sale acreage at the time the PLA agreements were closed rather than at the time they were executed. *See* Northwest Pet. at 26-29. This argument misses an essential point. Following execution, unless the agreements were defeated because Pacific Northwest was unable to obtain financing and regulatory approval for its pipeline proposal, the agreements were not conditional. Thus, once the agreements were executed, the lease sellers parted forever with the right to explore for and produce any gas underlying the subject acreage, unless Pacific Northwest proved unable or unwilling to satisfy its obligations. As a result, any post-execution development of the properties was undertaken solely for the benefit of the pipeline. The court of appeals was thus correct in focusing on the date of execution of the lease sales as the relevant time to determine Commission jurisdiction over the lease sellers. In any event, use of a later date would have made no difference. Northwest itself admits there were only 124 PLA wells on the various closing dates, Northwest Pet. at 28, less than one well for each 3,000 acres of the almost 375,000-acre PLA leaseholds, and far fewer than the 365 wells drilled on PLA-5 alone by 1977. *Cf.* Pet. App. at 16a.

[29] One witness characterized Amoco's PLA acreage as "an awful lot of goat pasture." R. 1701. After execution of the agreements and the transfer of acreage, the pipelines, in fact, *re*assigned to the respondents substantial portions of the acreage originally conveyed. For instance, over one-half of Mobil's acreage was reassigned within six years of the transfer. R. 345. By 1957, 29 percent of the 145,984 acres originally assigned by Amoco had been reassigned to it by the pipeline. R. 14,641-42.

[30] As the district court found, these cases are distinguishable on other grounds as well. *See* Pet. App. at 127a n.11, 133a.

Petitioners' other asserted conflicts are even less plausible. Several petitioners contend, for example, that the Fifth Circuit decision here is contrary to the decision of the same court in *Louisiana Land & Exploration Co. v. FERC*, 574 F.2d 204 (5th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979). *See, e.g.*, Northwest Pet. at 20 n.13; El Paso Pet. at 23; *cf.* FERC Pet. at 19. That case, however, involved a lessor's attempt to control the incidents of a sale of "proven and developed" reserves by its lessee. 574 F.2d at 208. Not only is that a very different issue from the one presented here, but two of the circuit judges who decided the *Louisiana Land* case also joined in the decision below. The contention that these two cases cannot be reconciled is thus frivolous at best.

Equally contrived is the argument that the decision below conflicts with *Cities Service Gas Co. v. FPC*, 424 F.2d 411 (10th Cir. 1969), *cert. dismissed*, 400 U.S. 801 (1971). *See* El Paso Pet. at 22; FERC Pet. at 17-18. That case involved the issue whether the spin-off of producing properties from a regulated pipeline to a nonaffiliated gas producer should permit the pipeline to charge its customers the price stipulated in its contract with the nonaffiliated company, rather than the lower cost-of-service price previously charged. *Id.* at 416-17. The Tenth Circuit's refusal to permit this transparent evasion of Commission regulation is perfectly consistent with the result reached below. Indeed, the Tenth Circuit expressly noted that, even if the Commission "had no authority over the spin-off of undeveloped gas leaseholds," it still had the power to remedy "the *consequences* of such action if it causes a detriment to the pipeline's ratepayers." *Id.* at 416 (emphasis added). In other words, whatever the Commission's authority to regulate the price collected by the nonaffiliated producer, it plainly retained the power to protect consumers by regulating the rates charged by the pipeline. As *Cities Service* indicates, such a situation is perfectly compatible with the regulatory scheme established under the Natural Gas Act.

Finally, the asserted conflict with *Mobil Oil Corp. v. FPC*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972), simply does not exist. In *Mobil*, the court of appeals turned aside an effort by the Commission to extend its jurisdiction under the Natural Gas Act to encompass virtually all gas royalty agreements.[31] The Commission's desire to protect consumers, the court observed, "is not sufficient justification upon which to base an expansion of the Act to activities clearly not within its terms. Congress did not give the FPC carte blanche to take whatever action it might consider appropriate in furtherance of this purpose." 463 F.2d at 263. Distinguishing *Rayne Field* as a case involving "gas reserves [that] were known and had been substantially developed," the court held that an ordinary gas lease, which "transfers only the right to explore, develop, and market if exploration is successful," *id.* at 262, is not jurisdictional. The court noted that, just as in this case, "no royalty is paid if no gas is discovered." *Id.*[32]

In summary, the Fifth Circuit properly applied the correct jurisdictional standard in determining that the

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[31] Northwest and El Paso allege an inconsistency between respondents' position in the present case and the position taken by some respondents in an unrelated set of petitions for certiorari in *Ashland Oil Co. v. Good*, No. 83-1234; *Mobil Oil Corp. v. Batchelder*, No. 83-1248; and *Cities Service Oil Co. v. Matzen*, No. 83-1278. *See* Northwest Pet. at 25 n.18; El Paso Pet. at 17 n.20; *cf.* FERC Pet. at 22 n.17. The issue in those cases, however, is not whether lease transactions are subject to Commission jurisdiction under the Natural Gas Act, but the level of royalties payable under leases containing a "market value" clause. *See Matzen v. Cities Service Oil Co.*, 233 Kan. 846, 667 P.2d 337 (1983) (cert. pending). Contrary to petitioner's contentions, there is no conflict in the positions of the respondents involved in these two cases.

[32] The overriding royalties here are plainly payable only for gas actually produced; there were no up-front payments of the kind found in *Rayne Field, Bastian Bay, Ship Shoal*, and the Barker Dome transaction. *See* Pet. App. at 127a & n.11.

lease transactions here were not "sales of gas" under the Natural Gas Act. Its decision is not in conflict with the decisions of other courts, nor does it raise any question of law having general significance for other pending or future cases. Indeed, because of (1) the unique facts presented here, (2) the enactment of the NGPA and (3) this Court's decision in the *Mid-Louisiana* case, the decision below deals with a situation that is highly unlikely ever to recur, and which therefore does not warrant this Court's attention.

II. THIS DECISION WILL NOT ADVERSELY AFFECT THE PUBLIC INTEREST

Frustrated in their efforts to demonstrate that this case raises a legal issue worthy of review by this Court, petitioners emphasize what they contend will be the adverse impacts of the decision below on the general public. These highly exaggerated assertions do not enhance petitioners' claims.

First, several petitioners charge that the decision below will "preclude the Commission from effectively regulating the rates charged for gas produced from fields that are major sources of supply for the two major interstate pipelines that serve the western United States." FERC Pet. at 11 (footnote omitted); *see also* California Pet. at 13; Northwest Pet. at 16; Oregon Pet. at 11. This assertion is nonsensical. The thrust of the litigation initiated by the pipelines was an attempt to convert land transactions which are not regulated into sales of gas which are regulated. The courts below held that, on the facts presented, the pipelines did not make their case. That the respondents are not subject to Commission regulation, however, does not mean that the rates charged to consumers are not regulated.

In point of fact, the two pipelines have operated the San Juan Basin properties for more than thirty years, producing the gas into their systems under Commission regulation and review of the cost to their customers. The Fifth Circuit decision does not alter or restrict in any way the power of the Commission to continue regulating the cost to the pipelines' customers of the production from the leases in question. Moreover, this Court's decision in the *Mid-Louisiana* case, *see* Part I.B. *supra*, ensures that absent extraordinary relief from the Commission the pipeline production involved here will be subject to NGPA pricing. Thus, the decision below in no way limits the Commission's ability to afford West Coast consumers "a complete, permanent, and effective bond of protection from excessive rates and charges." *Atlantic Refining Co. v. Public Service Commission*, 360 U.S. 378, 388 (1959).

Petitioners also allege that the decision below has deprived western gas consumers of refunds amounting to as much as $1 billion for past periods. *See, e.g.*, FERC Pet. at 21. Petitioners fail to acknowledge, however, the extreme unlikelihood that refund of such amounts would ever be required, even if the decision below were overturned. First, only one aspect of the complex jurisdictional question is presented here. Even if this Court were to rule in favor of petitioners, the case would still have to be remanded for resolution of a long list of other difficult issues, including the res judicata and collateral estoppel questions presented by the conflicting decisions of the district court and the Commission. *See* Pet. App. at 8a-9a; *see also* note 12 *supra*.[33] Only if all these issues were resolved in the pipelines' favor would the question of refunds even arise.

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[33] Respondents have not raised these questions here inasmuch as they were not addressed by the court below.

Further, the amount of refunds, if any, is highly controverted. Various parties submitted refund claims in the remedy proceeding instituted after the Commission's jurisdictional determination, *see* note 13 *supra*. Those claims were being vigorously contested at the time the Fifth Circuit issued its decision. The evidence offered by the respondents showed that they had, in fact, received *less*, not *more*, under the lease-sale transactions than they could have received as conventional sellers under the Natural Gas Act and the NGPA.[34] An additional indication of the questionable nature of the pipelines' refund claims is provided by the settlement agreement entered into by Northwest with Phillips, a principal PLA respondent. Under that settlement, the maximum refund liability, even assuming the PLAs are found jurisdictional, is approximately $30 million, a fraction of the refund amounts originally sought by Northwest and other parties.[35]

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[34] *See* Prepared Direct Testimony of John M. Little, *El Paso Natural Gas Co., et al.*, Docket Nos. CP74-314, *et al.* (filed Jan. 3, 1983). In addition, it should be noted that even before the *Mid-Louisiana* decision, Northwest had availed itself of the option offered by the Commission to price its gas production from post-1972 wells at the applicable national rates or NGPA ceiling prices. As a result, any refunds paid to Northwest would *not* be flowed through to Northwest's customers except to the extent they related to gas from pre-1973 wells.

[35] Northwest has entered into final and complete settlements with Phillips and Getty. The settlements provide that, if these lease-sales are ultimately held to be jurisdictional, Phillips and Getty would make refunds of approximately $30 million and $2 million, respectively, to Northwest. Neither settlement was opposed by Northwest's customers or the relevant state commissions. The Commission has given both settlements final approval and has terminated with prejudice the proceedings as to Phillips and Getty. Docket Nos. CP74-314, *et al.*, Order Approving Settlement Agreement (Nov. 23, 1983) (Phillips); Order Approving Settlement Agreement (Mar. 30, 1984) (Getty).

Finally, there is a substantial question whether the Commission's equitable power to order retroactive refunds should be exercised at all in a case such as this where two courts have found that the Commission lacks jurisdiction, and where the Commission itself has previously held the very transactions at issue nonjurisdictional. *See Transportation Enterprises, Inc. v. NLRB*, 630 F.2d 421, 426 (5th Cir. 1980). Since even the Commission's order instituting the remedy proceeding left open the possibility that refunds might not be ordered, *see* Pet. App. at 30a, it is evident that the entire question of refunds is highly speculative, and the amount even more speculative.

In short, the Fifth Circuit's decision will have no real impact on the consumers of this gas or on the public generally. The only significant effect of the decision is to thwart the pipelines' attempt to escape their obligations under the lease agreements. Petitioners' unfounded and exaggerated cries of alarm should not persuade this Court to grant review in a case that presents no issue warranting its attention.

CONCLUSION

For these reasons, the petitions for a writ of certiorari should be denied.

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May 11, 1984

Appendix

APPENDIX

[EXCERPT]

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Docket No. CP74-314

EL PASO NATURAL GAS COMPANY

STAFF'S COMMENTS TO COMPLAINT OF EL PASO NATURAL GAS COMPANY AND REQUEST FOR AN ORDER TO SHOW CAUSE

On June 3, 1974, El Paso Natural Gas Company (El Paso) filed with this Commission a complaint in which it alleges that certain persons are demanding increased payments for gas in violation of sections 4 and 7 of the Natural Gas Act. El Paso requests that the Commission (1) issue an order requiring those persons and others who may be affected to show cause why they should not be required to file rate schedules and obtain certificates of public convenience and necessity in accordance with Sections 4 and 7 of the Natural Gas Act; and (2) to schedule a hearing for the taking of testimony and for resolution of the issues presented by its complaint.

* * * * *

The Sales Are Nonjurisdictional

Should the Commission decide that it should reach the question of whether these agreements relate to sales subject to its jurisdiction, Staff respectfully recommends that a finding of no jurisdiction can be made without the necessity of formal hearing proceedings. El Paso relies

upon the Supreme Court's decision in *Rayne Field*[9] for resolution of the issues in this case. The Court in *Rayne Field* held that sales to an interstate pipeline company of leases covering proven and substantially developed reserves of gas to be sold in interstate commerce were subject to the Commission's jurisdiction. In that case several companies had entered into gas purchase contracts to sell their natural gas production in Rayne Field, Louisiana to Texas Eastern, an interstate pipeline company. Upon learning that they would be required to justify the agreed upon price upon the ground of public convenience and necessity, the producers agreed upon a different method for the sale of the Rayne Field gas. The new proposal called for Texas Eastern to purchase the producer's leasehold interests in the Rayne Field lands in which the natural gas was located. The gas reserves were proven, the same volumes of gas were to flow as under the original gas sale proposal, 19 of a proposed total of 26 wells were already in the ground and one of the sellers was to continue to do the bulk of production work. The Court concluded that the provisions of the lease-sale agreements were such that they were in economic effect conventional sales of natural gas.[10] The objective of the original proposal was to transfer large amounts of natural gas to an interstate pipeline company for resale in other states. The parties, in setting forth the lease-sale proposal were not altering their objectives, but merely the method of obtaining them.[11]

The *Rayne Field* decision is not controlling here since what was transferred under El Paso's contracts was the right to explore for and produce gas. The El Paso contracts were not part of a scheme to avoid Commission

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[9] *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965).

[10] *Id.*, p. 396.

[11] *Id.*, p. 401.

regulation since many were entered into years before the Supreme Court decided *Phillips Petroleum Co. v. Wisconsin, et al.*,[12] which held producer sales for resale in interstate commerce subject to FPC regulation. Unlike *Rayne Field*, where the seller retained his role as producer, El Paso is the producer of gas found within these San Juan Basin leases. Where a lease-seller, such as Delhi-Taylor Oil Corporation (Delhi), agreed to drill wells upon the subject lands, they did so expressly as independent contractors who were to be compensated for such services based upon the price being charged generally for such work in the San Juan Basin. Although the agreements contain a minimum payment provision couched in terms of a take or pay clause, El Paso made the major decisions controlling development of the fields and upon a determination that a unit was not productive or was unprofitable El Paso either was to reassign such unit to Delhi or, in the case of an unprofitable unit, had the option of making such reassignment.[13] El Paso has consistently recognized their role as producer in these fields by classifying the expenditures involved with these leases as pipeline production in rate cases before this Commission. The fact that a board of arbitrators has raised payments from 10¢ to 40¢ per Mcf does not now transform these into payments made to producers for sales for resale in interstate commerce.

In *Rayne Field*, the Court was particularly influenced by the fact that the gas reserves were proven and that approximately 75 percent of the wells to be drilled on this land were drilled prior to the agreement.[14] This is in contrast to the factual situation presented by the very

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[12] 347 U.S. 672 (1954).

[13] Oil and Gas Lease Sale Agreement between El Paso Natural Gas Co. and Delhi Taylor Oil Corporation, dated January 18, 1952, (El Paso's Exh. A, p. 14)

[14] *Rayne Field*, p. 296.

contract El Paso uses to support its complaint in which only 6.25 percent [15] of the Delhi wells were drilled prior to the agreement and the contract provided for a vigorous exploration and development program.[16]

The interests retained are analogous to those which were before the Court of Appeals in *Mobil Oil Corp.* v. *F.P.C.* [17] in which the court stated:

> "While the lease by the landowner provides for a royalty in the event of the discovery and sale of gas, typically he has no control over any incident of such sale either as to quantity to be sold, the price to be paid, the identity of the purchaser or whether it shall be sold in interstate or intrastate commerce. To refer to the royalty owner as engaging in the sale is to depart from the common understanding of the words used, industry parlance, economic equivalent, or any other foundation hitherto considered a source for discerning congressional intention." [18]

Although the interest holders were conveying the right to explore, develop and produce to an interstate transporter when they sold their leases to El Paso, they had no control over any incident of sale, either, as to quantity, price, identity of purchaser or whether it would be sold in interstate or intrastate commerce. In *Mobil* the court addressed a factual situation similar to the current El Paso problem when it considered that payments to royalty owners may be in excess of applicable producer rates and that producers would then seek relief in the courts. The court stated:

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[15] Information set forth in Brief of Commission Staff and Petition to Reopen Proceedings To Complete The Record, Docket No. G-6887, *et al.*, filed June 29, 1970.

[16] El Paso/Delhi Agreement Article VI.

[17] 463 F.2d 256 (U.S. CADC, 1971).

[18] *Id.*, p. 262.

"In any event we are not persuaded that the maintenance in either state or federal courts of contract (lease) controversies between royalty owners and lessees will undercut the federal regulatory system." [19]

The court then discussed various theories under which a court could reform the terms of a contract calling for royalty payments in excess of the producer ceiling and said:

"The court handling the contract clause could avoid becoming embroiled in the ascertainment of the federal ceiling by referring that issue to the FPC . . . This would bring the FPC into the dispute between the royalty owner and the lessee-producer, but the FPC would be acting properly, on reference from the courts, rather than unduly stretching its jurisdiction and the statutory mandate to extend to royalty owners.[20]

By considering a factual situation in which contractual payments per Mcf of gas exceeded the producer ceiling, the court implicitly recognized that such a factual setting does not invoke this Commission's jurisdiction over royalty interest holders. Therefore, the fact that El Paso may now be required, under its contract, to pay 40¢ or more per Mcf of gas does not make the recipients of these payments subject to the jurisdiction of the Commission, although such payments will be reviewed for justness and reasonableness, pursuant to Section 4 of the Natural Gas Act, in El Paso's wholesale rate filings to this Commission. The producer rate ceiling will also be used as a guideline by the court reviewing the demands made by the interest holders under their respective contracts.[21]

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[19] *Id.*, p. 265.

[20] *Id.*, pp. 265-66.

[21] *Id.*, p. 265.

Conclusion

For the reasons stated above, Staff respectfully urges that the Commission deny the Complaint of El Paso Natural Gas Company and Request For An Order To Show Cause filed June 3, 1974.

Respectfully submitted,

/s/ Daniel P. Behuniak
DANIEL P. BEHUNIAK
Commission Staff Counsel

Washington, D.C.
July 19, 1974

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Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443 and 83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

NORTHWEST PIPELINE CORPORATION, *et al.*,
Petitioners,

v.

PHILLIPS PETROLEUM COMPANY, *et al.*,
Respondents.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

SUPPLEMENTAL MEMORANDUM OF THE PLA RESPONDENTS

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June 13, 1984

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

IN THE

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---

SUPPLEMENTAL MEMORANDUM OF THE PLA RESPONDENTS

The PLA respondents respectfully submit this Supplemental Memorandum [1] commenting upon the settlements and proposed settlements that have been entered into in the proceedings underlying the case before this Court.

As the PLA respondents noted in their Brief in Opposition of May 11, 1984, at page 26 & n.35, respondent Phillips Petroleum Company has entered into a final and complete settlement with petitioner Northwest Pipeline

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[1] This Supplemental Memorandum is filed pursuant to the Court's letter of May 31, 1984, and Rule 22.6 of the Rules of this Court. A list of the PLA respondents and their corporate parents, subsidiaries and affiliates appears at pages ii to viii of the Brief in Opposition of the PLA Respondents.

Corporation. This settlement has already received the approval of the Federal Energy Regulatory Commission, which has terminated with prejudice the proceedings as to Phillips. Docket Nos. CP74-314, *et al.*, Order Approving Settlement Agreement (Nov. 23, 1983). The Northwest-Phillips settlement, which covers the majority of the PLA gas production, governs the determination of the overriding royalty with respect to production from and after October 1, 1982. In addition, Phillips has a contingent refund liability of $30 million,[2] payable only if this Court, or the Fifth Circuit, issues "a final, nonappealable order determining that the overriding royalties paid to Phillips under PLA-5 for the period September 25, 1980 to October 1, 1982, were subject to the regulatory jurisdiction of the Commission." Settlement Agreement ¶ VII. In the event this Court denies certiorari, or affirms the decision below, no refund is payable.

Getty Oil Company, another PLA respondent, has also entered into a final settlement with Northwest, on similar terms. If its lease-sale agreement is ultimately held to be jurisdictional, Getty would make a refund to Northwest of approximately $2 million; otherwise no refund is payable. The Northwest-Getty settlement has also received final Commission approval. Docket Nos. CP74-314, *et al.*, Order Approving Settlement Agreement (Mar. 30, 1984). Neither the Phillips settlement nor the Getty settlement was opposed by Northwest's customers or the relevant state commissions.

On May 18, 1984, subsequent to the filing of the Brief in Opposition of the PLA Respondents, petitioner El Paso Natural Gas Company and respondents Tenneco

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[2] This total is a fraction of the refunds initially sought. The Commission Staff estimated the potential refund liability of Phillips for the period February 1, 1974 to March 31, 1983, at $174 million. Docket Nos. CP74-314, *et al.*, Initial Comments of the Commission Staff on Offer of Settlement at 1 (June 9, 1983).

Oil Company and Conoco Inc. filed a proposed settlement with the Commission in these proceedings, which they characterized as "a full, fair, final and reasonable resolution of such proceedings as they affect El Paso, Tenneco Oil and Conoco." Docket Nos. CP74-314, *et al.*, Offer of Settlement and Joint Request for Approval of Stipulation of Settlement and Agreement at 1 (May 18, 1984). This proposed agreement, which is conditioned on Commission approval, would render this case moot as to a substantial portion of the natural gas production involved in these proceedings.[3] According to the Offer of Settlement, "Although relating to only four of eighteen GLA's at issue . . . , production attributable to these four GLA's constitutes approximately 70 percent of total production on all GLA's and approximately 15 percent of El Paso's total gas supply from the San Juan Basin. Thus, settlement by these parties will resolve as to the great majority of the gas involved . . . all issues as between El Paso, Tenneco Oil and Conoco . . . ." Offer of Settlement at 2. The Offer of Settlement further requests that the Commission direct the filing of a suggestion of mootness with this Court "at such time as the Commission's order approving the Settlement becomes final and no longer subject to judicial review." Offer of Settlement at 43-44.[4]

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[3] The PLA respondents agree with petitioner El Paso Natural Gas Company that this Court is not the appropriate forum in which to argue the merits or fairness of the proposed settlement. *See* Supplemental Memorandum of Petitioner El Paso Natural Gas Company With Respect to Settlements Between the Parties at 4 (June 8, 1974). That determination is plainly for the Commission to make in the first instance, and the question whether this settlement is in the public interest should not affect this Court's decision whether to grant or deny certiorari. The existence of the proposed settlement is nevertheless significant, because of the bearing it has on the continued vitality and potential impact of this controversy.

[4] Appendix B to the Supplemental Memorandum of Petitioner El Paso Natural Gas Company, filed June 8, 1984, similarly notes that "[a]fter Commission approval of the settlement by final order no

Under the proposed El Paso settlement with Tenneco and Conoco, the relationship among these parties is totally restructured. The properties covered by the Tenneco and Conoco GLAs are to be reconveyed by El Paso, with Tenneco and Conoco becoming conventional sellers of natural gas under 20-year gas sales contracts. Offer of Settlement at 15-16. In addition, the two respondent companies have a fixed refund liability of $50 million. Offer of Settlement at 24. Although the terms of the settlement are complex, and the PLA respondents have not had an opportunity to review them in detail, it appears that the payment of this $50 million refund is not contingent on the outcome of the case before this Court. Thus, although petitioners have contended that as much as $1 billion in refunds are at stake with respect to the GLA properties, *see* Joint Reply Brief in Support of Petitions for Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit at 4, and have made the amount of money at issue a principal ground in support of certiorari, El Paso is apparently willing to compromise its claim with respect to approximately 70 percent of the GLA production for $50 million.

Taken together with the other settlements which have been approved to date, the proposed El Paso settlement with Tenneco and Conoco underscores the point made by the PLA respondents in Part II of their Brief in Opposition. These settlements make unmistakably clear that neither the financial viability of the pipelines, nor their ability to operate in the public interest, will be seriously affected by any ruling this Court makes. Since, as the PLA respondents demonstrated in their Brief in Opposition, the petitioners have presented no significant legal or public interest issue warranting this Court's attention,

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longer subject to judicial review, El Paso, Tenneco, and Conoco shall file with the Supreme Court a suggestion of mootness to reflect that a full and final settlement as between these parties has been reached." Supp. Mem. at 7a.

there is plainly no ground for the granting of certiorari in this case.

CONCLUSION

For the reasons stated here, and in their Brief in Opposition, the PLA respondents respectfully renew their request that the petitions for a writ of certiorari be denied.

Respectfully submitted,

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June 13, 1984

Nos. 83-1321, 83-1432, 83-1433,
83-1442, 83-1443, 83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

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Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

On Petitions For A Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

BRIEF OF UNION OIL COMPANY OF CALIFORNIA, THE BEAMON PARTIES AND THE LUCERNE GROUP IN OPPOSITION

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May 11, 1984

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTION PRESENTED

Whether transfers of interests in essentially undeveloped natural gas leases to an interstate pipeline for exploration, development, and eventual production of gas for sale to the pipeline's customers, can constitute sales of gas within the jurisdiction of the Federal Energy Regulatory Commission, under Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b) (1982).

LIST OF PARTIES

The respondents adopt the list of parties in the Petition filed by the People of the State of California and the Public Utilities Commission of the State of California in No. 83-1321, at ii-vii. The respondent parties joining this brief are:

Union Oil Company of California ("Union")

Robert Beamon
Robert Beamon, Trustee
Pattie Ann Beamon Lundell
Thomas L. Hail, Trustee
(The "Beamon Parties")

W. Watson LaForce, Jr.
Henry P. Ishma, Jr. Estate
Robert T. Isham
Josephine C. Jacobson
J. Roberts Jones
Nancy LaForce Keyes
Frederic P. G. Lattner, Trustee,
U/T Martha M. Lattner, Settlor
Suzanne LaForce Baber
James C. Bard
Douglas N. Bard
Ralph A. Bard, Jr.
Roy E. Bard, Jr.
G. Brainard, Jr. Trust
Continental Illinois National Bank and
Trust Company, Trustee Trust #23935
Continental Illinois National Bank and
Trust Company, Trustee Trust #23949
Eleanor Isham Dunne
Charles W. Farnham, Jr.
Robert B. Farnham
Walter B. Farnham

Elizabeth B. Farrington
Minnie A. Fitting
R. U. Fitting, Jr. Estate
Robert D. Fitting
Nancy H. Gerson
John R. Grimes
Ruth N. Halls
Cortland T. Hill
Elsie F. Hill
Louis W. Hill, Jr.
Albert L. Hopkins, Jr.
George S. Isham
R.S. MacDonald, A. MacDonald and
Northern Trust Co., Trustees
U/W of N.S. MacDonald, Deceased
Mary F. Love
William J. McDermott, Trustee
Nora R. Ranney
Catherine H. Ruml
Edward L. Ryerson, Jr.
Sabine Royalty Corporation
Shaw, Isham & Company
John I. Shaw, et al., Trustee
James Simpson, Jr. Trust
William E. Simpson Trust
Sydney Stein, Jr.
Northern Trust Co., Trustee, U/W of John Stuart
Robert Douglas Stuart Estate
William P. Sutter
Michael Simpson Trust
Patricia Simpson Trust
Katharine I. White
Kay B. Gundlach
Frederick F. Webster Trust
Mary S. Zick

David Waller Dangler
(The "Lucerne Group")

SUBSIDIARIES (EXCEPT WHOLLY OWNED SUBSIDIARIES) AND AFFILIATES OF RESPONDENT UNION OIL COMPANY OF CALIFORNIA:

Kaneb Services, Inc.

Magma Power Co.

Unocal

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On Petitions For A Writ Of Certiorari To The United States Court of Appeals For The Fifth Circuit

---

BRIEF OF UNION OIL COMPANY OF CALIFORNIA, THE BEAMON PARTIES AND THE LUCERNE GROUP IN OPPOSITION

Respondents Union Oil Company of California ("Union"), the Beamon Parties (Robert Beamon, Individually and as Trustee; Tom L. Hail, Trustee; and Pattie Ann Beamon Lundell), and the Lucerne Group (W. Watson LaForce, Jr. *et al.*) respectfully request that this Court deny the petitions for writ of certiorari, seeking review of the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

STATEMENT OF THE CASE

The petitions in this case[1] arise out of a series of lease sales that occurred during the early 1950's in the San Juan Basin area of northwestern New Mexico. The earliest of these were between El Paso Natural Gas Company ("El Paso") and certain predecessors of the various respondents; these were called Gas Lease Agreements or GLA's. Later but essentially similar transactions involved Pacific Northwest Pipeline Company and other respondents or their predecessors; these were called Pacific Lease Agreements or PLA's.[2]

Geology of the San Juan Basin

The numerous leases that were the subject of the 35 GLA's involved in this proceeding covered hundreds of thousands of acres in a general area of New Mexico referred to as the San Juan Basin. Consulting geologists retained by El Paso expressed great confidence that "large volumes of natural gas were available for extrac-

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[1] Petitions for Writ of Certiorari have been filed by the People of the State of California, *et al.* ("California") (No. 83-1321); the Public Utility Commissioner of Oregon, *et al.* ("Oregon") (No. 83-1432); Northwest Pipeline Corporation, *et al.* ("Northwest") (No. 83-1433); El Paso Natural Gas Company ("El Paso") (No. 83-1442); Pacific Gas and Electric Company, *et al.* ("PG&E") (No. 83-1443); and the Federal Energy Regulatory Commission ("FERC") (No. 83-1618). Citations to the various petitions will be in the form "California Pet. at ____." The appendix prepared by California will be cited as "Pet. App. at ____."

[2] Union is a party to GLA's 76, 348, and 349. The Beamon Parties have interests under GLA's 77, 350, and 351. The Union GLA's apply to five-sixths, and the Beamon GLA's, one-sixth, of the working interest in substantially the same leases. The Lucerne Group is a party to GLA 66. This brief in opposition specifically addresses only the GLA transactions.

tion." Pet. App. at 53a. But it was obvious in the early 50's that the gas-bearing formations in the basin are "of varying depths and thicknesses," *id.* at 52a, and are "characterized by relatively low porosity and permeability," *id.* at 52a; *see also id.* at 9a, 127a. Since "[r]ecovery of natural gas from each productive formation is a function of the variations in the permeability and in the porosity of the formation," *id.* at 127a, and since the "Basin's geologic structure does not reveal those variations in any productive formation," *id.* at 127a-128a, the district court found that "geologic structure has little or no direct influence upon the localization of recoverable gas reserves," *id.* at 128a. For this reason the district court found, *id.*, and the court of appeals specifically affirmed, *id.* at 9a, that "*actual drilling is the only method of definitely locating recoverable gas saturations*" in the basin. (Emphasis added.)

Moreover, "[b]ecause the productive formations are tight, even where drilling located recoverable reserves, completed wells delivered gas in low volumes." *Id.* at 128a. In fact, the district court found that at the time the GLA's were executed, "[w]ells in the Basin generally were incapable of recovering commercially significant amounts of gas. . . . [T]hese wells [were] generally of such low deliverability that a producer could not hope to recoup his drilling costs. . . ." *Id.* at 132a. In short, only a regulated pipeline—which could include capital costs in its rate base and other drilling and operating costs in its cost of service, thus assuring that the slower the gas production the greater the aggregate return—could afford to develop these properties. *Id.* at 128a, n.13.

It was for these reasons that respondents' predecessors sold, and El Paso[3]—"in effect trading on its status as a utility regulated on the 'cost of service' basis," *id.* at 133a—purchased, the leases in question.[4] What was transferred pursuant to the GLA's were the leases or working interests—that is, the right to explore for, develop, and produce the gas reserves that were thought to underly the leases.[5] In exchange for that right, respondents' predecessors retained an overriding royalty, applicable only to the net working interest assigned, expressed in terms of cents per thousand cubic feet of gas

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[3] At the time most of the GLA's were executed, El Paso was the only interstate pipeline serving the basin. A second interstate pipeline was later constructed to the basin, and for a time a second customer for natural gas was available. However, El Paso soon purchased that pipeline in violation of the antitrust laws. *See* United States v. El Paso Natural Gas Pipeline Co., 376 U.S. 651 (1964).

[4] The GLA's here at issue were preceded by the so-called "Barker Dome transaction" (GLA-32) which most petitioners disingenuously advance as evidence of an intent to evade Commission jurisdiction, even though it is not involved in this proceeding. *See, e.g.*, El Paso Pet. at 4-6; FERC Pet. at 4-5. Both the district court and the Commission have rejected that theory, finding that the "parties did not enter into the GLA's [here at issue] as a means of shifting payments as in *Rayne Field* [United Gas Improvement Co. v. Continental Oil Co., 381 U.S. 392 (1965)]." Pet. App. at 133a; *and see* William G. Webb, 49 F.P.C. 17, 26 (1973). The district court explained that "the history of the Barker Dome agreement is not analogous to the agreements here at issue." Pet. App. at 125a, n.5. *Inter alia*, the Barker Dome agreement provided for an up-front payment tied to an estimate of reserves, whereas these GLA's did not. *Id.* at 127a & n.11.

[5] The first GLA's transferred only gas rights. But contrary to the Commission's assertion, FERC Pet. at 7, oil rights were also transferred by later GLA's. For example, GLA 348 transferred to El Paso Products Co. rights to all of the oil underlying that acreage.

produced from the acreage,[6] subject to escalation and redetermination at specified intervals.

Early Procedural History

For the next twenty years, the GLA's were consistently treated as nonjurisdictional lease sales (rather than sales of natural gas for resale in interstate commerce) by all parties, including the Federal Power Commission.[7] Thus, passthrough of the overriding royalties as an element of the cost of service of El Paso's own pipeline production was consistently sought by El Paso and regularly approved by the Commission—neither ever suggesting that the royalties were in fact payments for sales of gas. In *William G. Webb*, 49 F.P.C. 17 (1973), the Commission directly addressed the argument, made by its staff, that it "should regulate the transfer of the gas reserves here involved from the producers to El Paso in

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[6] The petitioners attempt to distinguish the form of the royalties here from those paid in the usual lease transaction. *See* FERC Pet. at 7, n.9; El Paso Pet. at 7-8. Those arguments fail to recognize the obvious: all royalties (including those here at issue) may be stated as a percentage of total production revenues. The fact that the so-called "special overriding royalty" was paid to the respondents based on the percentage interest they sold to El Paso (rather than on the totality of production) can have no significance. Similarly insignificant is the level at which the royalty is set. That a "base" royalty is frequently one-eighth (12 1½%), and the "special overriding" royalties here constitute a higher percentage has no legal or evidentiary significance. Royalties of all types—regular, overriding, or special overriding—can be found at all levels, high and low. To allow the level of the royalty to determine the Commission's jurisdiction would exalt form over substance.

[7] Both the Federal Power Commission and its successor the Federal Energy Regulatory Commission are referred to herein as "the Commission."

accordance with the *Rayne Field* case." *Id.* at 25. Agreeing with El Paso's position in that case, the Commission held that "the transactions should *not* be considered equivalent to the *Rayne* transactions because they arose under different circumstances." *Id.* at 26. The Commission thus rejected the staff's appeal that it hold these lease sales jurisdictional.[8]

Only when arbitration pursuant to the terms of the agreements resulted in the fixing of the royalty under one GLA at a level unacceptable to El Paso did that petitioner for the first time assert—in the suit that led to these petitions—that the lease sales were jurisdictional sales of gas. Following a seven-week trial, the United States District Court for the Western District of Texas found that "little if any actual drilling had been done on any acreage when its respective GLA was executed," and that "each GLA" was, therefore, "an agreement to transfer acreage which was not substantially developed." Pet. App. at 132a. The court next found that the "GLAs in issue were not transfers of leases with proven reserves . . . [b]ecause insufficient drilling had been done to prove up reserves in the specific acreage transferred. . . ." *Id.* at 131a. Finally, the court found that the GLA's "were not the economic equivalents of gas sales contracts," since "these agreements arose from the unique economic situation of the parties and reflected their efforts to structure the transactions so that El Paso would explore for and develop gas reserves in the Basin." *Id.* at 133a. On this basis the court held that "each agreement at issue in this

[8] The owners of the interests adjudicated in *Webb* (respondents here) have consistently argued that the *Webb* holding of nonjurisdiction is *res judicata* as to them. Because of its decision on the principal issues, the court of appeals did not reach that question. Pet. App. at 19a.

litigation . . . is not a 'sale in interstate commerce of natural gas for resale' within the meaning of Section 5 of the Natural Gas Act of 1938.' " *Id.* at 134a-135a.

This conclusion was particularly appropriate in the context of the Union, Beamon and Lucerne GLA's. On the 26,687.41 acres covered by GLA 76, for example, only four wells had been drilled at the time the agreement was signed. On GLA 348, transferring deeper rights to the same acreage, only two wells were in existence at execution. Pet. App. at 66a-67a. GLA's 77 and 350 applied to one-sixth of the working interest in leases on substantially the same lands. *Id.* Lucerne's GLA 66 had no wells on 2,480 acres at execution. *Id.* The GLA's thus allocated to El Paso the burdens and risks of exploring, developing and producing the acreage, retaining for the predecessors of Union, the Beamon Parties, and Lucerne only the right to receive an overriding royalty on El Paso's production.[9]

Court Of Appeals Decision

El Paso appealed the district court decision to the Fifth Circuit. While that appeal was pending, the Commission instituted a proceeding to reconsider the jurisdictionality

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[9] Contrary to El Paso's assertion, Union did not "voluntarily accept . . . reassignment" of its GLA leases. *See* El Paso Pet. at 10, n.12. Union agreed to accept reassignment of GLA's 76, 348, and 349, effective October 1, 1983, only in settlement of a state court lawsuit brought by El Paso. *See* El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (Dist.Ct. of Harris County, 11th Judicial Dist. of Texas, Feb. 27, 1984). The settlement leaves the jurisdictional question unresolved for periods prior to October 1, 1983. The Beamon Parties and the Lucerne Group have rejected El Paso's purported reassignments, and the state court litigation confirmed their right to do so.

of the GLA's. Relying on the stipulated district court record—supplemented by some new evidence principally concerning agreements not litigated in the district court—the Commission on September 25, 1980 reversed its three-decade-old position and held that the GLA's are subject to its jurisdiction. Pet. App. at 21a. Petitions for review of the Commission decision were consolidated with the pending appeal from the district court holding, and the court of appeals addressed both together.

The court of appeals held that the GLA's are not sales of gas as defined by the Natural Gas Act, 15 U.S.C. §§ 717-717z (1982) ("NGA"). Pet. App. at 5a. It looked to the three-pronged test of *Continental Oil Co.* v. *Federal Power Commission*, 370 F.2d 57 (5th Cir. 1966), *cert. denied* 388 U.S. 910 (1967) ("*Ship Shoal*"), derived from this Court's opinion in *Rayne Field.*[10] Noting that a lease sale transaction is not jurisdictonal "[u]nless all the *Rayne Field* factors . . . are satisfied," Pet. App. at 14a-15a, the court focused on one prong of the *Ship Shoal*/*Rayne Field* test: substantial development. A unanimous panel specifically held that the "reserves underlying the leaseholds were not substantially developed at the time the lease sales were executed because of the lack of 'imminent ability to produce in commercial quantities.' " *Id.* at 15a (quoting *Ship Shoal*, 370 F.2d at 64). Explaining this holding, the court acknowledged that "[a]n important factor" was "the limited extent to which the Basin had

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[10] The test is comprised of three questions:

"(1) Is the economic effect of the transfer similar to that of a conventional sale?

"(2) Is the subject of the transaction 'proven and substantially developed' reserves?

"(3) Is the transfer of the reserves for purpose of interstate transmission and resale?" 370 F.2d at 62.

been drilled at the time the GLAs and PLAs were executed." *Id.* at 15a. It noted that "the few wells in the ground when the agreements were executed could not have come close to depleting the acreage," *id.* at 16a, and pointed out that both the Commission and the courts have considered the number of wells existing at execution (in comparison to the number needed to complete production) a relevant factor, *id.* at 16a-17a (citing *Texas Gas Transmission Corp.*, 3 FERC (CCH) ¶ 61,135 (1978), and *Rayne Field*, 381 U.S. at 396 and n.3, 403 and n.8).

Because of its holding that the GLA's were not substantially developed, the court of appeals had no occasion to address the district court's finding that the GLA's did not transfer proven reserves[11] and were not the economic equivalents of gas sales. Thus, the only questions before this Court are whether substantial development should continue to be a requirement of the *Rayne Field* test, and if so, whether the court of appeals erred in holding that the GLA's were not substantially developed. If the judgment below is reversed, however, the court of appeals will still have to consider the correctness of the district court's holdings that the GLA's did not transfer proven reserves and were not the economic equivalent of sales of gas. It will also have to decide other difficult questions, such as the *res judicata* and collateral estoppel issues flowing from the *Webb* case and the district court decision.

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[11] The court of appeals suggested in passing that "the reserves *in the Basin* may well have been 'proven' at least within reasonable estimates." Pet. App. at 15a (emphasis added). However, the Court did not purport to analyze that issue and certainly did not pass on the district court's finding that the existing reserve estimates covered the Basin as a whole and could not be related to *specific leases* without substantial further drilling. *See Id.* at 131a.

REASONS FOR DENYING THE WRIT

I. Review Of The Judgment Below Is Not Required To Protect The Public Interest

A. The Court of Appeals judgment has no prospective effect on gas consumers

A decision to reverse the decision below would have no prospective impact on natural gas consumers. A jurisdictional holding would require that the GLA gas be priced at or below Natural Gas Policy Act, 15 U.S.C. §§ 3301-3432 (1982) ("NGPA"), ceilings. But, as the Commission concedes in its petition, from the effective date of the NGPA (December 1, 1978), "[i]f the lease transactions are deemed to be non-jurisdictional . . . the pipelines [can] charge their customers only the applicable NGPA rate rather than the cost-of-service rate." FERC Pet. at 21. In other words, El Paso and other pipelines are now required to price their post-NGPA production at or below the applicable NGPA rate, regardless of the amount they pay in special overriding royalties or other production costs. This requirement stems from the decision of this Court in *Public Service Commission of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. ____, 103 S.Ct. 3024, 77 L.Ed.2d 668 (1983) ("*Mid-La*"). Accordingly, whether it is reversed or not, the judgment below will not affect what consumers pay for gas from and after the effective date of the NGPA.

To be sure, the Commission is empowered to increase the price that can be charged by El Paso so as to cover the costs resulting from its payment of the special overriding royalties. *See* NGPA § 104(b)(2), 15 U.S.C. 3314(b)(2) (1982); *Federal Energy Regulatory Commission* v. *Pennzoil Producing Co.*, 439 U.S. 508 (1979). But the responsibility of the Commission is to watch out for the

overall benefit of consumers.[12] The Commission could not, therefore, restrict its analysis of a request for higher rate to the particular leases at issue here. Rather, it would be required to take a comprehensive look at the impact of all current developments in gas pricing before granting such extraordinary relief to El Paso. Thus, it is significant that El Paso will receive a considerable windfall (as much as $20 million in 1983, $30 million in 1984, and more thereafter)[13] from the application of the *Mid-La* decision to pipeline production not here at issue. Payment of the special overriding royalties out of El Paso's own pocket would, at most, reduce slightly the extent of that windfall. In any event, no price in excess of the NGPA ceiling may be charged without prior Commission approval based on its independent assessment of what constitutes a just and reasonable rate.

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[12] The Natural Gas Act does not require the Commission to make price adjustments merely to prevent a producer (such as El Paso) from losing a portion of its profits due to royalty increases. *See* Federal Energy Regulatory Comm'n v. Pennzoil Producing Co., 439 U.S. 508, 517 (1979); *accord*, Cities Service Gas Co. v. Federal Power Comm'n, 424 F.2d 411 (10th Cir. 1969).

[13] These amounts are estimates transmitted orally to the Commission by El Paso. Letter from Charles A. McManus (Director, FERC Office of Congressional, Intergovernmental and Public Affairs) to Rep. Phillip R. Sharp (Chairman, Subcommittee on Fossil and Synthetic Fuels, U.S. House of Rep.) (Aug. 8, 1983). An exhibit in evidence in El Paso Natural Gas Co. v. Tenneco Oil Co., et al., No. 83-50539 (Dist. Ct. of Harris County, 11th Judicial Dist. of Texas, Feb. 27, 1984) contains an in-house El Paso estimate that revenues over the next twenty years will, because of *Mid-La*, be $4.6 billion more than they would otherwise have been.

B. Reversal of the Court of Appeals judgment is unlikely to benefit consumers retroactively.

Most petitioners emphasize the enormous refunds that would allegedly flow to consumers from a reversal of the court of appeals judgment. *See, e.g.*, FERC Pet. at 20-21; El Paso Pet. at 9, n.8; PG&E Pet. at 13-14. That argument is little more than a pipe dream.

First, as noted above a reversal of the instant court of appeals judgment would only require that court to review the other grounds for the district court's holding (inability to particularize proved reserves for individual leases and lack of economic equivalency). Even if the district court findings were overturned on those issues, the court of appeals would still be required to resolve thorny problems of *res judicata* and collateral estoppel, as even El Paso admits. *See* El Paso Pet. at 25; Pet. App. at 19a. Only if all of these issues were resolved in favor of El Paso would there be any predicate for the refunds sought by the pipeline.

Second, the Commission proceeding to determine whether refunds should be ordered, and if so in what amounts, had not yet even reached the hearing stage when it was suspended as a result of the court of appeals decision. However, Union and other respondents had submitted testimony in that proceeding suggesting that they had in fact been *underpaid* rather than overpaid by El Paso for the GLA gas during past periods. In short, El Paso's refund claim is at this point nothing more than a litigation position which remains to be tested.

Third and most important, even if there have been overcharges resulting from the parties' treatment of the GLA's as nonjurisdictional, the Commission's authority under the NGA to order refunds is far from unfettered; such extraordinary relief can only be granted where the

equities warrant it. *See, e.g., Laclede Gas Co.* v. *FERC*, 670 F.2d 38, 42 (5th Cir. 1982). The Commission has recognized that the absence of notice that a sale was jurisdictional is of particular concern in the weighing of factors for and against refunds. *See, e.g., Delta Gas, Inc.*, 43 F.P.C. 620, 623 (1970); *Hugoton Production Co.*, 41 F.P.C. 490, 497 (1969). An administrative agency may abuse its discretion by changing its position on a jurisdictional issue, and then imposing retroactive liability for failure to foresee that change. Like other administrative agencies, the Commission "may not render jurisdictional decisions, overrule them *retroactively* and thereby transform [a producer's] interim behavior, legal when pursued, into illegal [acts]." *Transportation Enterprises, Inc.* v. *National Labor Relations Board*, 630 F.2d 421, 424 (5th Cir. 1980) (emphasis in original).[14]

In short, the Commission's September 25, 1980 decision to assert jurisdiction over the GLA's was a radical departure from a three-decade-old position. Given its

[14] The situation addressed by the Fifth Circuit in *Transportation Enterprises* was remarkably similar to that which would face any court hearing a request for retroactive application of the jurisdictional ruling pronounced by the Commission in this case. The N.L.R.B. had, through its regional office, ruled that a particular enterprise was outside its jurisdiction—just as here the Commission ruled in *William G. Webb* that some of the GLA's were outside of its jurisdiction. Years later, pursuant to an appeal from a subsequent ruling, the Board reversed its earlier jurisdictional ruling—just as here the commission has reversed *Webb* some years later in response to a subsequent petition by El Paso. The court in *Transportation Enterprises* ruled that the company was subject to the Board's jurisdiction from the date of the new jurisdictional decision. But prior to that decision, the company "had the right to rely on the decision . . . that it was not subject to the jurisdiction of the NLRB." 630 F.2d at 424. The respondents here had a similar right to rely on the Commission's decisions in *Webb* and in various El Paso rate cases, as well as on the district court's 1977 non-jurisdictional holding.

history of treating these transactions as non-jurisdictional, it would be simply impermissible for the Commission to impose refund liability retroactively for the period during which the parties—including all of the petitioners—treated the transactions as non-jurisdictional, even if El Paso ultimately prevails on the jurisdictional issue *and* proves overcharges.

C. The private dispute between El Paso and the respondents does not merit Supreme Court review.

Given the *sui generis* nature of the GLA transactions, the lack of impact that the court of appeals judgment can have on future gas prices, the retention by the Commission of authority fully to protect consumer interests, and the unlikelihood of refunds relating to past periods, the only remaining dimension of this case is the private contractual dispute between El Paso and the respondents. That dispute has already been the subject of a decade of negotiations, arbitration, and litigation; there is no need further to prolong its final resolution. To the extent that El Paso is unable to recover all of its costs of producing natural gas from the GLA leases, it merely suffers the consequences of its own decision to enter into the GLA's.

Moreover, the discussion of the impact of the judgment below on El Paso must occur in the context of the post-*Mid-La* world. El Paso stands to gain $4.6 billion from its newly-acquired ability to charge NGPA rather than cost-of-service rates to its customers.[15] To the extent that El Paso's operation of the GLA properties is in fact unprofitable,[16] its windfall is merely reduced somewhat.

[15] *See* n. 13, *supra*, and accompanying text.

[16] El Paso has been unable to establish this proposition in litigation brought in Texas state court. El Paso Natural Gas Co. v. Tenneco Oil Co., *et al.*, No. 83-50539 (Dist.Ct. of Harris County, 11th Judicial Dist. of Texas, Feb. 27, 1984). At the very least, the decision of the

The possible reduction of the amount of that windfall due to a private contractual relationship between El Paso and the respondents provides no basis for this Court to hear the instant case.

II. The Decision Of The Court Of Appeals Is Correct On The Merits.

A. The decisions of this Court properly require substantial development as a prerequisite for Commission jurisdiction over lease sales.

The petitioners point out, quite correctly, that the Commission has jurisdiction "over the rates of all wholesales of natural gas in interstate commerce." *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, 682 (1954). But that statement, oft paraphrased in the petitions, is beside the point; the question before the Fifth Circuit (and the question for which the writ is requested) was whether these sales of leases in fact constituted wholesales of natural gas. As the Commission put it, "the dispositive question is whether what was sold was gas or merely the right to explore for gas." FERC Pet. at 19.

Addressing that question, this Court established in *Federal Power Commission* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949) *("Panhandle")*, that sales of undeveloped natural gas leases are not covered by the NGA. However much petitioners dislike that decision, it has not been overturned. Even in *Rayne Field* this Court continued to recognize that sales of "the particular kind of leases that were before the court" in *Panhandle*, are outside the jurisdiction of the Commission. 381 U.S. at

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Texas court makes clear that mere assertions that El Paso will lose money on its production from the GLA properties cannot be accepted at face value.

404. The Court reached a different result in evaluating the *Rayne Field* lease sales only because it noted

> "[t]wo distinctions. . . . *First*, the *Panhandle* leases were undeveloped. The Rayne Field leaseholds were substantially developed. . . . *Second*, *Panhandle* did not involve a sale of natural gas for resale in interstate commerce, but a transfer by an interstate transmission company to a production company for sale of the gas in *intra*state commerce." 381 U.S. at 403-04 (footnote omitted) (emphasis in original).

There can be no question that the substantiality of development is a separate and appropriate criterion for determining jurisdictionality. The fact that this Court in *Rayne Field* distinguished *Panhandle* "first" on the basis that the "*Panhandle* leases were undeveloped," *id.* at 403, makes clear that the Court viewed substantial development as an issue separate and apart from whether the acreage was proven. Any doubt on this score was resolved by the Court's explanation:

> "The substantially of development is a relevant consideration, for the more that must be done before the gas begins its interstate journey, the less the transaction resembles the conventional wellhead sale of natural gas in interstate commerce which, as *Phillips* held, the Act has affirmatively placed within Commission jurisdiction." *Id.*

The court of appeals "perceive[d]" that this Court's concern with substantial development reflects its "concern with the apparent congressional intent not to regulate production." Pet. App. at 15a. This Court has held that the "production or gathering" exemption *see* NGA § 1(b), 15 U.S.C. § 717(b) (1982) "relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction." *Rayne Field*, 381 U.S. at 402.

The very essence of the "physical activities, processes and facilities of production" is the drilling of wells, the placement of casing, the erection of platforms, and the like.

The close identification of the drilling function with production or gathering is the key to understanding the relationship identified in *Rayne Field* between substantial development and economic equivalency. The *sine qua non* of a gas sale is that the seller has borne the risks[17] and expenses of drilling the well from which gas is produced. If those risks and expenses are transferred to the buyer—as they are in a sale of undeveloped leases—then the lease sale simply cannot be economically equivalent to the sale of gas.[18] For that reason, the court of appeals implicitly concluded that the lack of substantial development, and the consequent placement of the risks and burdens of drilling on the pipeline purchaser of the leases, made the GLA's quite different from jurisdictional sales

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[17] The risks here were substantial. Both the district court and the court of appeals specifically found that "actual drilling is the only method of definitely locating recoverable gas saturations" on the GLA's. Pet. App. at 9a; *see id.* at 128a.

[18] Both El Paso and the Commission noted that, even under a traditional gas sales contract, the producer ordinarily does not fully develop the property until he has obtained sales commitments for the gas. El Paso Pet. at 6, n.3; FERC Pet. at 17, n.15. That answer misses the point. Even if he waits until he has a sales contract in hand, it is still the producer who bears the risk and expense of drilling under such a contract. However, if a lease owner transfers his undeveloped lease, then the risk and expense of drilling are on the purchaser, and the transaction is not economically equivalent to a gas sale. That is what the district court meant when it found that "[t]he structuring of the economic risks and benefits between the parties more closely resembles the reallocation of risks and benefits in a farm-out than in a gas sales contract." Pet. App. 133a.

of gas. That decision is squarely—and properly—required by the opinions of this Court.

B. Substantiality of development is appropriately measured by the number of wells drilled.

Petitioners assert, however, that even if substantial development is a proper test, the court of appeals erred in counting wells and comparing the number of wells drilled with available drilling spaces. *See, e.g.*, FERC Pet. at 18-19. Elsewhere, however, the Commission has espoused the very approach it condemns here.

In *Texas Gas Transmission Corp.*, 3 FERC (CCH) ¶ 61,135 (1978), for example, the Commission looked carefully at the development of the leases prior to finding that their sale was not a jurisdictional sale of gas. The Commission noted that considerable development had taken place prior to the sale; fourteen wells had been completed, ten were already producing, and additional wells had been started. The Commission observed, however, that plans were "under way to complete 50 wells that had been started and abandoned [by the seller] and to start an additional 50 new wells." *Id.* at p. 61,405. It therefore concluded that the sellers "had not sufficiently developed the field to be able to conduct economically feasible wellhead arrangements." Thus, the Commission in *Texas Gas Transmission* made a jurisdictional decision by looking at the extent of development, and comparing the drilling completed with that required for full development.

Even more illuminating is the Commission's practice in administering the incentive price provision in section 107(c)(5) of the NGPA, 15 U.S.C. § 3317(c)(5) 1983), as it relates to "tight formations." In that context the Commission has developed the practice of excluding areas that were "substantially developed" prior to the issuance of an

infill drilling order, provided certain other factors are also present. In determining which areas are substantially developed, the Commission counts wells—that is, it looks to the "total number of developed [drilling] units . . . divided by the total number of available [drilling] units." Order No. 220, FPC Docket RM79-76 (April 2, 1982), 47 Fed. Reg. 15316 (1982). Significantly, the Commission has held that 41% development "does not . . . [constitute] substantial development." *Id.* at 15317. None of the significant GLA's here at issue even approached 41% development as of the date of execution.[19]

C. The decision below is consistent with *Ship Shoal*.

All of the petitioners insist that the decision of the court below conflicts with *Ship Shoal*, an earlier decision by another panel of the same court. But a careful comparison of the two decisions belies that assertion.

As a matter of law, in deciding the case at bar the court below applied precisely the same three-pronged test it had formulated in *Ship Shoal*. Pet. App. at 12a. If the assertion is that the court below applied its own *Ship Shoal* test improperly, it is the responsibility of the Court of Appeals for the Fifth Circuit and not the responsibility of this Court to resolve that issue.[20] A conflict between

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[19] For example, based on 160 acre spacing, the four Pictured Cliffs wells completed on GLA's 76 and 77 as of the date of execution constituted approximately 2% development. *See* Pet. App. at 66a. The Mesa Verde formation underlying GLA 76 was *undrilled* at the date of execution. *Id.* By May 1, 1975, there were 167 wells in the Pictured Cliffs and 63 wells in the Mesa Verde formation. *See* Joint Appendix at 232a-233a, El Paso Natural Gas Co. v. Sun Oil Co., 708 F.2d 1011 (5th Cir. 1983).

[20] The appeals court's summary denial of petitioners' suggestions for rehearing *en banc*, without a single dissenting vote, suggests that the Fifth Circuit itself saw no conflict with *Ship Shoal*. Pet. App. at 152a.

panels of the same court does not generally present a question for which certiorari will be granted. *See Davis* v. *United States*, 417 U.S. 333, 340 (1974); *Wisniewski* v. *United States*, 353 U.S. 901 (1957) *(per curiam)*.[21]

In any event, however, the court of appeals had ample factual basis on which to distinguish this case from *Ship Shoal*. In *Ship Shoal*, twelve wells had been drilled on 3,000 acres, with multiple completions, prior to the sale.[22] That is the equivalent of one well for each *250 acres*. Here the situation was vastly different. Development prior to execution of the GLA's[23] had been extremely limited. The

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[21] Mr. Justice Harlan has noted that "contrary decisions between different panels of the same Court of Appeals will not be considered to present a reviewable conflict, since such differences of view are deemed an intramural matter to be resolved by the Court of Appeals itself." Harlan, *Manning the Dikes*, 13 Rec. A.B. City N.Y. 541, 552 (1958).

[22] As the presiding examiner noted in his initial decision:

> "The CATC producers before May 10, 1961 had erected three drilling platforms at Ship Shoal and had drilled about 12 wells, with multiple completions, therefrom. Costs to the producers do not appear, but depreciable property of the producers at Ship Shoal seems to have been $2,280,000. . . . Substantial quantities of gas and oil were found. The gas was shut in, and has remained unconnected to date. Some of the oil was produced, and was barged to shore from storage tanks on the platforms." *Tennessee Gas Transmission Co.*, 30 F.P.C. 759, 799 (1963).

[23] The Commission assails the court's use of the date of execution as the time to measure development. FERC Pet. at 17, n.15. But petitioner fails even to acknowledge "the controlling authorities"—*Rayne Field* and *Ship Shoal*—on which the court based its conclusion that "jurisdiction must be evaluated at the time lease-sale agreements are executed." Id. at 17a. The reason for that conclusion is apparent: Upon execution, the parties are bound to their agreement; the actual transfer of title that occurs at closing is but a ministerial act required by the prior agreement. The jurisdictionality of the deal must be determined when the parties become bound to it.

court cited "dramatic example[s] of the lack of substantial development." Pet. App. at 16a. Union's GLA 348 is such an example; it had only two wells on over 26,000 acres—less than one for each 13,000 acres. Pet. App. at 66a-67a. Not only could the court fairly conclude that "the acreage was far less drilled than the land covered by the agreements found jurisdictional in *Rayne Field*," *id.* at 15a, it was also compelled to conclude that development had not reached the point that had been reached in the *Ship Shoal* case.

D. The *Louisiana Land, Mobil,* and *Cities Service* decisions demonstrate the propriety of the decision below.

Various of the petitions also suggest that the decision below conflicts with three other court of appeals decisions: *Louisiana Land and Exploration Co.* v. *Federal Energy Regulatory Commission*, 574 F.2d 204 (5th Cir. 1978), *cert. denied*, 439 U.S. 1127 (1979) (*"Louisiana Land"*); *Mobil Oil Corp.* v. *Federal Power Commission*, 463 F.2d 256 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 976 (1972) (*"Mobil"*); and *Cities Service Gas Co.* v. *Federal Power Commission*, 424 F.2d 411 (10th Cir. 1969), *cert. dismissed*, 400 U.S. 801 (1979) (*"Cities Service"*). On the contrary, these cases in fact support the conclusions of the court below.

The most recent of the three cases, *Louisiana Land*, was decided by a panel that included two of the judges who heard the appeal in the instant case.[24] The panel recognized, as the Commission had found, that the *Louisiana Land* "transaction was closely connected with [a] lease-sale transaction." *Delta Development Co.*, 56 F.P.C. 922, 925 (1976). *See* 574 F.2d at 206-07. But the

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[24] Circuit Judges Brown and Roney were joined by Judge Godbold in *Louisiana Land*, and by Judge Tjoflat in this case.

jurisdictional question addressed by both the Commission and the court of appeals in *Louisiana Land* had to do with an "agreement [that] arose from separate negotiations." 56 F.P.C. at 925. Evaluating that separate transaction, the court of appeals declined to apply its three-pronged *Ship Shoal* test because, as the court accurately noted, Louisiana Land and Exploration "did not sell a lease in a transaction that mirrors those in *Rayne Field* and *Ship Shoal.*" 574 F.2d at 207. Instead the court distilled the essence of the *Ship Shoal* analysis: a determination of jurisdictionality must not "ignore . . . economic realities." *Id.* Application of that general principle led the panel to conclude that the *Louisiana Land* transactions were jurisdictional, while the clearly compatible *Ship Shoal* test itself later compelled an opposite conclusion in the case of the GLA lease sales.

Similarly consistent with the result and rationale below is the decision of the Court of Appeals for the D.C. Circuit in *Mobil.* The court there rejected an attempt by the Commission to extend its jurisdiction to cover royalty provisions of oil and gas leases. The *Mobil* court evaluated the " 'significant and determinative economic facts'," as required by *Rayne Field.* 463 F.2d at 262. It therefore recognized the basic economic difference between oil and gas leases, which transfer only the right to explore, develop, and market (if exploration and development are successful), and sales of oil and gas produced from such leases, *id.* at 262-63, much as the court below recognized the differences between sales of undeveloped leases and the sale of gas-in-place by transfer of proved and developed leases.[25]

[25] Significantly, the *Mobil* court noted that exclusion of royalty arrangements from the Commission's jurisdiction would not prevent the Commission from achieving its purposes—*i.e.*, "to protect the

In *Cities Service*, the Tenth Circuit did not even address the question of jurisdiction. Rather, recognizing its lack of "jurisdiction over security transactions relating to natural gas companies," 424 F.2d at 417, the Commission proceeded to consider "the proper allowance in [Cities Service] Gas Co.'s cost of service for gas from production properties it previously owned," *Continental Oil Co.*, 39 F.P.C. 1034, 1047 (1968). The court of appeals held that the Commission's lack of jurisdiction over the transfer did "not foreclose the FPC from fixing appropriate rates under the Act," 424 F.2d at 417, and affirmed a Commission order requiring Cities to pay more for gas than it was authorized to charge, *id.* at 415. Thus, the Tenth Circuit upheld precisely what El Paso and the Commission complain about here.

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ultimate beneficiaries [of the NGA] against exploitation by natural gas companies." *Id.* at 263. "[T]he FPC's jurisdiction over rates chargeable by a producer includes authority to determine the reasonableness of costs incurred, even though these are not subject to direct FPC control. . . ." *Id.*

CONCLUSION

The petitions for writ of certiorari should be denied.

Respectfully submitted,

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May 11, 1984

Nos. 83-1321, 83-1432, 83-1433
83-1442, 83-1443, 83-1618

IN THE

Supreme Court of the United States

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THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
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**On Petitions For A Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

SUPPLEMENTAL MEMORANDUM OF UNION OIL CO. OF CALIFORNIA

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IN THE

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SUPPLEMENTAL MEMORANDUM OF UNION OIL CO. OF CALIFORNIA

Respondent Union Oil Company of California ("Union") files this Supplemental Memorandum pursuant to the invitation of the Court, as evidenced by the Clerk's letter of May 31, 1984. Although Union will leave it to the parties to that settlement to discuss the offer of settlement and agreement filed with the Federal Energy Regulatory Commission ("FERC") on May 18, 1984,[1] it de-

[1] Union cannot help noting, however, the stark inconsistency between the statement on p.3 of the Supplemental Memorandum of Petitioner El Paso Natural Gas Company ("EP. Supp. Mem.") ("[n]either settlement renders the matters before the Court moot, in whole or in part") and point G of the summary of the El Paso-Tenneco-Conoco settlement, which provides that the parties "shall file with the Supreme Court a suggestion of mootness to reflect that a full and final settlement between the parties has been reached" (EP. Supp. Mem. at 7a).

scribes and discusses below its own settlement, entered into on November 11, 1983.[2]

As noted in Union's Brief in Opposition, p. 7, n.9, the November 11, 1983 settlement between Union and El Paso Natural Gas Co. ("El Paso") does not purport to affect periods prior to its effective date. It therefore leaves the jurisdictional question raised by the petitions, and the issue of potential refunds, unresolved for the retroactive period.

Union agreed to accept reassignment of the leases covered by GLA's 76, 348, and 349, upon receipt from the FERC of a satisfactory certificate under Section 7(c) of the Natural Gas Act, 15 U.S.C. § 717f(c) (1982) ("NGA"), and acceptance by the FERC of the gas purchase contract negotiated between Union and El Paso as Union's initial rate schedule under Section 4 of the NGA. Pursuant to that agreement, Union filed, on December 13, 1983, an application with the FERC for a certificate of public convenience and necessity authorizing it to sell gas from the GLA leases to El Paso. That application remains pending in Docket No. CI84-141-000.

Contrary to the assertion at EP.Supp. Me. 5, the questions before the FERC in Docket CI84-141-000 do not depend on the outcome of the jurisdictional issue presented in the petitions. Only in El Paso's convoluted world—where GLA transactions that have been uniformly treated and defended as nonjurisdictional for twenty years suddenly become jurisdictional when it suits El

[2] The parties are currently discussing certain proposed changes in the Union settlement; however, none of the changes presently under consideration would affect the general principles of the settlement set out below.

Paso's business needs—can its agreements to *settle* these cases be viewed as *supporting* its petition for review by this Court.

The Union settlement, if it becomes effective, would eliminate, as to Union, the jurisdictional issue presented by the petitions for periods after its effective date. To that extent, therefore, it would also eliminate any public interest in review of the jurisdictional question.

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On Petitions for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF OF RESPONDENTS, WILLIAM G. WEBB, *et al.*, IN OPPOSITION

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May 11, 1984

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether the opinion below has any prospective effect in view of Congress' determination through passage of the Natural Gas Policy Act, 15 U.S.C. § 3301 *et seq.*, to exempt from the Federal Energy Regulatory Commission's jurisdiction under the Natural Gas Act, 15 U.S.C. § 717 *et seq.*, natural gas that was not already dedicated under such statute prior to November 8, 1978.

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BRIEF OF RESPONDENTS, WILLIAM G. WEBB, *et al.*, IN OPPOSITION

As respondents, William G. Webb, *et al.*, (Webb)[1] oppose the petitions for a writ of certiorari to the United

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[1] This brief in opposition is filed on behalf of the following respondents:

William G. Webb, Estate of J. Glenn Turner, Benson-Montin-Greer Drilling Corporation, B & M Construction Corporation, Earl A. Benson, *et al.*, Edna Fern Benson, Oliver Benson, Walter Benson, Barbara Ann Bruss, Albert Greer, Charlene

States Court of Appeals for the Fifth Circuit filed by The People of the State of California, *et al.* (California) in No. 83-1321; The Public Utility Commission of Oregon, *et al.* (Oregon) in No. 83-1432; Northwest Pipeline Corporation, *et al.* (Northwest) in No. 83-1433; El Paso Natural Gas Company (El Paso) in No. 83-1442; Pacific Gas and Electric Company, *et al.* (Pacific) in No. 83-1443; and the Federal Energy Regulatory Commission (Commission) in No. 83-1618.[2]

STATUTES INVOLVED

Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), provides:

> The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transporta-

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Greer, Charles Albert Greer, La Plata Gathering System, Inc., Jack London, Jr., O. J. Lilly, Barbara Irene McConnell, A. C. Montin, Jr., William V. Montin, Estate of C. W. Murchison, Oklahoma and Northwestern Company, Frank A. Schultz, Sue Reeder Turner Trust, Jaqulyn Williams.

In Opinion No. 642, 49 F.P.C. 17 (1973), the Federal Power Commission (now the Federal Energy Regulatory Commission) held the lease-sale transactions of these Webb parties to be non-jurisdictional, *i.e.*, not subject to the Commission's jurisdiction under the Natural Gas Act. The order of the Commission now under review purports to hold that these same lease-sale transactions, as well as other, different lease-sale transactions involving other parties, are jurisdictional. The Webb parties do not waive and specifically reserve their rights under the doctrines of collateral estoppel and *res judicata* which they raised below, but which the court below did not address. 708 F.2d 1011 at 1020 (App. 1a at 19a).

[2] Pursuant to Rules 22 and 34.2, Webb adopts the portions of the Petition filed by California in response to Rule 21.1(b), (d), and (e). The Appendix (App.) references in this brief are to the appendix volume filed by California with its petition in No. 83-1321.

tion or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 601(a)(1)(A) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3431(a)(1)(A), provides:

Sec. 601. Coordination with the Natural Gas Act.

(a) Jurisdiction of the Commission Under the Natural Gas Act—

(1) Sales—

(A) Natural Gas Not Committed or Dedicated.—For purposes of section 1(b) of the Natural Gas Act, effective on the first day of the first month beginning after the date of the enactment of this Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of enactment of this Act solely by reason of any first sale of such natural gas.

REASONS FOR DENYING THE WRIT

Aside from the fact that the decision of the Fifth Circuit is correct on both the law and the facts of this case, the argument advanced by the petitioners as to why this Court should grant certiorari does not exist. The petitioners' common theme is that the decision of the Fifth Circuit, if allowed to stand, will create a regulatory loophole in the Commission's jurisdiction under the Natural Gas Act ("NGA") through which future lease sale transactions can slide.[3] The simple answer is that Congress

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[3] All the petitioners in one form or another state that "this case presents an important question concerning the scope of the Commission's jurisdiction under the Natural Gas Act." Pet. of FERC (No. 83-1618), page 10; Pet. of California (No. 83-1321), page 13;

has already determined through passage in 1978 of the Natural Gas Policy Act ("NGPA") to terminate the Commission's jurisdiction under the Natural Gas Act with respect to such future transactions. Thus, as a result of Congress' passage of the NGPA, this case stands alone and has no precedential effect as to new lease sale transactions because such new transactions are by law now exempt from the NGA.

Through passage in 1978 of the Natural Gas Policy Act, Congress determined to freeze the jurisdiction of the Commission under the Natural Gas Act, and to limit the scope of the NGA to that natural gas which had already been committed or dedicated under the NGA. By NGPA § 601(a)(1)(A), 15 U.S.C. § 3431(a)(1)(A), Congress excluded from all future jurisdiction of the Commission under the NGA first sales of natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, the day before the date of the enactment of the NGPA. Even with respect to natural gas which was already dedicated under the NGA, NGPA § 601(a)(1)(B), 15 U.S.C. § 3431(a)(1)(B), removed from any continuing Commission jurisdiction under the NGA high-cost natural gas [as defined in Section 107(c), 15 U.S.C. § 3317(c)], new natural gas [as defined in Section 102(c), 15 U.S.C. § 3312(c)], and natural gas produced from new onshore production wells [as defined in Section 103(c), 15 U.S.C. § 3313(c)].

In *Pennzoil Co. v. FERC*, 645 F.2d 360, 380 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142, the Fifth Circuit explained the NGPA's restriction on the Commission's NGA jurisdiction. The Fifth Circuit observed that the effect of NGPA § 601(a)(1) was to prevent "the universe of gas subject to the NGA from expanding" and to remove "from continuing NGA jurisdiction sales of certain gas

Pet. of Oregon (No. 83-1432), page 18; Pet. of Northwest (No. 83-1433), page 14; Pet. of El Paso (No. 83-1442), page 12; and Pet. of Pacific (No. 83-1443), page 2.

that nevertheless was committed or dedicated to interstate commerce on November 8, 1978." Similarly, in *Public Service Commission of the State of New York v. Mid-Louisiana Gas Co.*, —— U.S. ——, 103 S. Ct. 3024, 3031, 77 L.Ed.2d 668, 678 (1983) this Court explained:

> The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called "first sales" of natural gas.

Thus, it is clear that, by passage of the NGPA, Congress has precluded prospective application of the NGA to natural gas which was not already committed or dedicated on November 8, 1978, when the NGPA was enacted.

As a result, lease sales consummated today, or at any time after the effective date of the NGPA, are exempt from any jurisdiction of the Commission under the NGA even if lease sales are construed to be sales of gas.[4] This is so because such leases sales would generally involve new natural gas that had not previously been produced and therefore had not been committed or dedicated prior to 1978. Being of such uncommitted stature, NGPA § 601(a)(1)(A) would expressly preclude application of the Commission's jurisdiction under the NGA to such lease sales, even if they constituted sales of gas. Consequently, even if the petitioners were correct in their argument that the Fifth Circuit's opinion restricts the Commission's jurisdiction under the NGA, their argument

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[4] Assuming *arguendo* that lease sales may be construed as sales of gas, the only exception to this statement is the unlikely instance where a new lease sale might involve gas that was already committed or dedicated prior to enactment of the NGPA. But even as to these lease sales the Commission would retain its pre-existing NGA jurisdiction only if the gas involved was not "new high cost gas," "new natural gas," or "gas from new onshore wells." See NGPA § 601(a)(1)(B). Respondents are not aware of any such lease sales of previously committed gas having been made since passage of the NGPA, and petitioners cite to none.

provides no basis for granting certiorari because Congress has already determined by enactment of the NGPA to preclude Commission jurisdiction under the NGA with respect to such sales.

Since the NGPA now bars the ultimate question presented in this case from arising again, the petitions for a writ must fail. An analogous situation arose in *Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70 (1955). In that case, after oral argument and affirmance by an equal division of this Court, it became evident, on a petition for rehearing, that a subsequently enacted state statute "bars the ultimate question presented in this case from again arising in that State." 349 U.S. at 73. Accordingly, the Court dismissed the writ as "improvidently granted." To the same effect is *Cook v. Hudson*, 429 U.S. 165 (1976).

A student of this Court's practice, Mr. R. L. Stern, has stated:

> The first and obvious conclusion to be drawn from the cases discussed is that a conflict will not necessarily result in the granting of certiorari if the issue is no longer a live one. In the first four cases the statute upon which the controversy rested had expired or been amended in a manner which would prevent the problem from arising in the future. In each case, it was nevertheless true that a substantial number of pending or potential cases would still be controlled by resolution of the conflict. But this did not convince the Court that review of the decisions of the court of appeals was warranted.[5]

So far as respondents are aware, there are no pending cases involving the assertion of NGA jurisdiction over lease-sale transactions. The only real question petitioners raise is "no longer a live one," but turns only on the particular facts of this case alone under the Natural Gas Act.

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[5] Stern, *Denial of Certiorari Despite a Conflict*, 66 Harv. L. Rev. 465, 470 (1953).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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SUPPLEMENTAL MEMORANDUM OF RESPONDENTS, WILLIAM G. WEBB, *ET AL.*

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---

SUPPLEMENTAL MEMORANDUM OF RESPONDENTS, WILLIAM G. WEBB, *ET AL.*

William G. Webb, *et al.* ("Webb parties"),[1] respondents herein, file this supplemental memorandum pursuant to the notice of the Clerk of this Court, dated

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[1] This supplemental memorandum is filed on behalf of the respondents specifically enumerated at page 1, fn. 1, of the Brief of Respondents, William G. Webb, *et al.* in Opposition, filed May 11, 1984. It should be understood that throughout the course of these proceedings the Webb parties do not waive and specifically reserve their rights under the doctrines of collateral estoppel and *res judicata* which they raised below, but which the Court below did not address. 708 F.2d 1011 at 1020 (App. 1a at 19a).

May 31, 1984. By said notice, counsel were invited to address the offer of settlement and joint request for approval of stipulation of the settlement and agreement that was filed with the Federal Energy Regulatory Commission ("Commission") on May 18, 1984, as said settlement or other agreed upon settlements bear on the pending petitions for writs of certiorari.[2] The Webb parties submit that the settlement agreements already executed between various parties in these proceedings further demonstrate that this case is not one which warrants an affirmative exercise of this Court's extraordinary and discretionary certiorari jurisdiction.

As the Webb parties pointed out in their Brief in Opposition, p. 4:

> Thus, as a result of Congress' passage of the NGPA,[3] this case stands alone and has no precedential effect as to new lease-sale transactions because such new transactions are by law now exempt from the NGA.[4]

No party in any of the reply briefs that have been submitted has challenged the conclusion that the NGPA has limited this case to its facts. In fact, as the Government states in its Reply Memorandum for the Petitioner, p. 5:

> —we submit that the future ramifications of this *one case alone* are themselves sufficiently substantial to warrant certiorari. (emphasis added).

Assuming *arguendo* the "fall back" position of the petitioners to be correct that the facts of this single case

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[2] On May 30, 1984, Petitioner, El Paso Natural Gas Company ("El Paso") and Respondents, Tenneco Oil Company ("Tenneco") and Conoco Inc. ("Conoco") filed a joint suppleemntal brief advising this Court that a comprehensive settlement agreement had been entered into between El Paso and Tenneco and Conoco, which was being filed with the Federal Energy Regulatory Commission on May 18, 1984.

[3] Natural Gas Policy Act of 1978, 15 U.S.C. § 3301, *et seq.*

[4] Natural Gas Act of 1938, 15 U.S.C. § 717, *et seq.*

alone justify certiorari, the settlement agreements would severely restrict the area left to be adjudicated. Thus, the issue which the petitioners seek to present on certiorari is no longer a "live one," either in the context of a pervasive precedent or in the context of the facts of this case, itself.

This case involves lease sales to Northwest Pipeline Corporation ("Northwest") and El Paso Natural Gas Company ("El Paso"). Lease sales to Northwest are designated as "PLA's," and those to El Paso as "GLA's." The Commission by order of November 23, 1983, 25 FERC ¶ 61,292, has already approved a settlement involving PLA-5 between Northwest and Phillips Petroleum Company. PLA-5 is the largest of the PLA's covering approximately 202,000 acres of land in the San Juan Basin. 25 FERC at 61,672. The Commission by order issued March 30, 1984, 26 FERC ¶ 61,421 also approved a settlement involving PLA-3 between Northwest and Getty Oil Company. El Paso has entered into a settlement agreement with Union Oil Company of California dated November 11, 1983, and filed with the Commission on December 13, 1983, involving GLA's 76, 348 and 349. The latest GLA settlement agreement to surface is that about which this Court was recently apprised. Such agreement is between El Paso and Tenneco-Conoco and involves GLA's 47, 52, 60 and 78. These four GLA's represent nearly seventy percent of the El Paso volumes that are involved here. Although the two El Paso settlement agreements have not been as yet approved by the Commission, the fact remains that there is comparatively little acreage and gas remaining outside of that involved in the settlement agreements. In other words, there is little left that a decision of this Court, even if certiorari were granted, can affect.

For the foregoing reasons and those stated in our brief in opposition, the petitions for a writ of certiorari should be denied.

Respectfully submitted,

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SUPPLEMENTAL MEMORANDUM OF PETITIONER EL PASO NATURAL GAS COMPANY WITH RESPECT TO SETTLEMENTS BETWEEN THE PARTIES

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v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

On Petitions For Writs Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

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SUPPLEMENTAL MEMORANDUM OF PETITIONER EL PASO NATURAL GAS COMPANY WITH RESPECT TO SETTLEMENTS BETWEEN THE PARTIES

By letter dated May 31, 1984, the Clerk of the Court advised all counsel in the proceedings captioned above of the Court's direction that counsel be provided with the opportunity of filing a supplemental memorandum discussing the offer of settlement and joint request for approval of stipulation of settlement agreement that was filed with the Federal Energy Regulatory Commission ("FERC") on May 18, 1984, and commenting upon any other agreed upon settlement between parties to these cases which might have bearing upon the pending petitions for writs of certiorari.

Petitioner El Paso Natural Gas Company ("El Paso") welcomes the opportunity to lay to rest any questions which might exist with respect to the relationship between certain settlements to which it is a party and the cases now pending before the Court on petitions for writs of certiorari, and accordingly files this supplemental memorandum.

I. Status of Settlements

On November 11, 1983, El Paso entered into a settlement agreement with Union Oil Company of California ("Union").[1] A brief description of the settlement is set forth in Appendix A *infra*. Pursuant to the settlement agreement, Union filed with the FERC in Docket No. CI84-141 an application for those Commission authorizations necessary to implement the settlement. By order issued May 10, 1984, the Commission directed that a hearing be held on issues raised by the gas sale authorizations sought by Union, and a prehearing conference has been scheduled before an Administrative Law Judge on June 20, 1984.

On May 9, 1984, El Paso entered into a Stipulation of Settlement and Agreement with Tenneco Oil Company ("Tenneco") and Conoco Inc. ("Conoco"). A brief description of the settlement between El Paso and Tenneco and Conoco is set forth in Appendix B, *infra*. On May 18,

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[1] The settlement agreement provides that either party may terminate the agreement if Union did not receive requisite FERC authorizations by April 1, 1984. Such authorizations were not received, and thus either party to the agreement is free to terminate the agreement at this time. El Paso and Union are in the process of discussing and negotiatiating amendments to their settlement in light of the May 9, 1984 settlement reached between El Paso, Tenneco, and Conoco.

1984, a joint "Offer of Settlement and Agreement" was filed by El Paso, Tenneco, and Conoco with the FERC. On May 30, 1984, the Commission noticed the Offer of Settlement and related applications and has provided that any party desiring to file comments with respect to the Offer of Settlement should, on or before July 2, 1984, file such comments with the Commission; the Commission has also provided that reply comments are due to be filed on or before July 12, 1984.

II. Relationship Between the Settlements and the Cases Pending Before the Court

Neither the Union nor the Tenneco/Conoco settlement disposes of the GLA jurisdictional issue presented to the Court in the pending petitions for a writ of certiorari. Neither settlement renders the matters before the Court moot, in whole or in part. Neither settlement is intended or structured to affect the Court's decision to grant or deny the petitions for certiorari.

It is critical that the Court, and all parties to these cases, understand that neither settlement is self-executing as between the settling parties. Affirmative action by the FERC is required—after appropriate Commission review and consideration of the public interest, the public convenience and necessity, and the reasonableness of the proposed settlement arrangements—before the settlement arrangements can be fully effectuated.

El Paso advises the Court that the proposed settlement arrangements do not terminate any case now pending before the Court, do not dispose of the GLA/PLA jurisdictional issue presented in the pending petitions for writs of certiorari, and do not in any manner lessen the

importance of the Court's grant of the petitions and reversal of the judgments of the United States Court of Appeals for the Fifth Circuit.

What, then, is the purpose of the settlement agreements, if they do not terminate the issues between the settling parties? Even a casual reader of the record will comprehend fully that when the GLA jurisdictional issue presented in these cases is laid to rest by this Court, there will remain—without regard to whether the Fifth Circuit is affirmed or reversed—extraordinarily complex regulatory, economic, and operational questions that, if left to further litigation, may take years for final resolution. El Paso has attempted, therefore, to arrive at an appropriate resolution of all these issues through comprehensive settlement. El Paso believes that the settlement arrangements provide a reasonable, prudent, public interest resolution of a broad spectrum of issues that must be resolved irrespective of the Court's decision on the merits of these cases.

In El Paso's judgment, this is neither the time nor the forum in which to litigate the merits of the settlement proposals. Whether or not El Paso is correct in its assessment that the settlement is in the public interest must necessarily await a full review by the Commission of the totality of the settlement arrangements, which resolve issues of gas supply, gas contracting, gas pricing, natural gas liquids processing, and gas gathering and transportation. The settlement arrangements will stand or fall, dependent upon the Commission's assessment of the settlement arrangements in the light of the public interest as found and determined by the Commission.

Most importantly, it is obvious that the Commission's determination of where the public interest lies will be affected by whether the lease sales are jurisdictional sales as contended in the petitions for certiorari. It is therefore of paramount importance that this Court finally resolve the merits of the jurisdictional issue presented by the petitions. Once the jurisdictionality of the GLA transactions is determined by this Court, there will be a clear standard by which the settlement arrangements can be tested for the traditional regulatory criteria of prudence, justness, reasonableness, and public convenience and necessity. Until this is done, it will be difficult, if not impossible, for the Commission and all affected parties to gauge whether the settlement arrangements are appropriate, in the public interest, and deserving of all necessary Commission authorizations and approvals. The proposed settlement arrangements underscore the need for the Court's prompt determination of the jurisdictionality of the GLA transactions. Indeed, this Court could best serve the public interest by summarily reversing the judgments below, as requested in El Paso's petition.

III. Conclusion

El Paso strongly endorses the granting of certiorari to review the patently erroneous decision below. El Paso concurs in the statement of the Solicitor General in the Reply Memorandum for the Petitioner, p. 6, that ". . . we submit that the future ramifications of this one case alone are themselves sufficiently substantial to warrant certiorari." The filing of the proposed settlement arrangements[2] in no way alters the accuracy of this statement.

Respectfully submitted,

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[2] El Paso has not reached settlements with Atlantic Richfield Co., Sun Oil Co., and other producers. Hence, the pending settlements if approved do not stop the excessive payments that El Paso makes to these producers.

APPENDICES

APPENDIX A

The El Paso/Union Settlement

The November 11, 1983 Settlement Agreement between El Paso and Union provides for the following:

A. El Paso will reconvey to Union the interests in GLA's 76, 348 and 349 which El Paso acquired from Union's predecessor in interest.

B. After reconveyance, Union will sell gas produced from the reassigned interest pursuant to the terms of a gas purchase contract attached to the Settlement Agreement. In pertinent part, the Gas Purchase Agreement establishes the following terms and conditions:

1. Price: maximum lawful price as permitted under the Natural Gas Act or the Natural Gas Policy Act of 1978, except that NGPA Section 107 incentive regulated gas shall be priced at the NGPA Section 102 applicable monthly price.
2. Term: two years, plus guaranteed renewals for a second term of three years, and a third term of five years.
3. Coverage: all gas produced from the reassigned GLA properties.
4. Market-out: El Paso in its sole discretion, subject only to non-discriminatory application systemwide where similar market-out rights exist, can lower the price otherwise payable to that price which represents the value to El Paso of the gas to be purchased.
5. Take-or-pay: 50 percent or daily stabilized producing capacity, subject to regulation by government authority or force majeure intervention.
6. Processing rights: If El Paso processes Union's gas, El Paso shall receive 23 percent of the liquids as a processing fee.

7. Reservations: Union reserves to itself 25 percent of the gas produced from the reassigned acreage from wells commenced subsequent to the date of first deliveries under the Gas Purchase Agreement.

8. Transportation: El Paso will transport the reserved gas, if requested, charging a transportation fee corresponding to that fee charged for similar services under other agreements at the time such right is exercised.

C. If El Paso notifies Union on or before April 1, 1985 that it proposes to construct a new natural gas processing plant in the San Juan Basin, El Paso's processing fee of 23 percent shall be renegotiated.

D. If by April 1, 1985 El Paso and Union have not reached agreement with respect to a new gas processing plant, Union shall have the option to arrange separately for the processing of gas produced from its properties and sold to El Paso.

E. If El Paso should resolve by settlement with either Tenneco or Conoco its presently outstanding dispute regarding GLA 47, on a basis which includes the execution and implementation of a gas purchase agreement, Union shall have the option to be exercised within 45 days after the effectiveness of such gas purchase agreement to supersede prospectively the gas purchase agreement between El Paso and Union with a gas purchase agreement in form and substance identical to that entered into between El Paso and either Tenneco or Conoco.

F. Immediately upon execution of the settlement agreement, appropriate pleadings will be prepared and filed by Union with the FERC seeking (1) all requisite certificate authority to sell and deliver natural gas to El Paso from wells subject to the FERC's certificate author-

ity pursuant to the terms and conditions of the gas purchase agreement, (2) acceptance of the gas purchase agreement as Union's initial rate schedule, and (3) FERC determination of applicable NGPA prices.

G. In the event Union has not received a FERC certificate and acceptance by the FERC of the gas purchase agreement as Union's initial rate schedule on or before April 1, 1984, either Union or El Paso shall have the right upon written notice to the other to terminate the settlement agreement.

H. If the FERC's certificate and rate schedule orders impose a condition repugnant and unacceptable to Union, it may reject the proferred certificate authority and may cancel the agreement.

I. El Paso and Union agree to amend certain existing gas purchase agreements between them with respect to gas produced and sold from non-GLA acreage, the amendatory agreements being attached to the settlement agreement.

J. For the period of time from October 1, 1983 and ending on the earlier of (a) the date upon which Union accepts all requisite authorizations issued by the FERC regarding the sale and delivery by Union to El Paso of natural gas produced from the reassigned properties or (b) the 91st day after Union's rejection of unsatisfactory FERC authorizations, or (c) the 91st day after either Union or El Paso has duly elected to terminate the settlement agreement, overriding royalty payments are to be made by El Paso to Union on the basis of the applicable first sale maximum lawful price established by the Natural Gas Policy Act of 1978 (but in no event less than the NGPA Section 104 "replacement" rate) less seven cents per Mcf.

K. El Paso and Union agree to execute a motion for submission to the Court in Harris County, Texas in El Paso Natural Gas Company v. Tenneco Oil Company, *et al.* No. 83-50539, dismissing without prejudice Union as defendant in El Paso's declaratory judgment action and dismissing without prejudice Union's counterclaims against El Paso.

APPENDIX B

The El Paso-Tenneco-Conoco Settlement

The Stipulation of Settlement and Agreement between El Paso, Tenneco, and Conoco dated May 9, 1984 and filed with the FERC on May 18, 1984 provides as follows:

A. The Settlement will not become effective until (1) an order of the FERC approving the Offer of Settlement, the Stipulation of Settlement and all operative agreements and issuing all certificates, approving all abandonments within its jurisdiction, and granting all other authorizations that are necessary to implement the Settlement Agreement and permit performance of every operative agreement sought by the parties hereto has issued; (2) such order has become final and no longer subject to judicial review; and (3) such order has been found by each of El Paso, Tenneco, and Conoco to be acceptable to it.

B. Tenneco and Conoco jointly have the option to effect a reassignment of the GLA properties and become conventional sellers while the settlement is before the Commission, but if they so elect, however, their status as conventional sellers will be prospective only, effective upon the grant of necessary sales authorizations from the Commission, and all remedies of all parties as to periods prior to the producers' assumption of status as conventional sellers will be resolved in the event of a jurisdictional decision by this Court through future Commission proceedings.

C. El Paso will reconvey to Tenneco and Conoco the interests in GLA's 47, 52, 60, and 78 which El Paso acquired from the predecessors in interest of Tenneco and Conoco.

D. Tenneco and Conoco will each become conventional sellers of natural gas under gas purchase con-

which contracts establish the following terms and conditions:

1. Price: NGPA prices for §§ 102, 103, 107, 108 gas; \$2.00/MMBtu for all other gas through June 30, 1986, reduced on July 1, 1986 to § 106(a) NGPA price level.
2. Term: 20 years.
3. Coverage: all GLA gas, with Tenneco/Conoco to have option to add all presently undedicated San Juan leases to the contract.
4. Market-out: El Paso in its sole discretion, subject only to non-discriminatory application systemwide where similar market out rights exist, can reduce the applicable price to that level which represents the value of the gas to El Paso. Upon an El Paso price reduction, Tenneco/Conoco can withdraw marketed-out gas if abandonment is not required.
5. Reservations: Tenneco/Conoco each reserves 25% of the gas produced from the re-assigned interests, if the reserved gas is not subject to the abandonment requirements of the Natural Gas Act.
6. Transportation: El Paso will transport market-out and reserved gas, subject to receipt of regulatory approvals.
7. Take-or-pay: 60%, both contracts, for 2 years. 75% as to Tenneco, 74.4% as to Conoco thereafter. Take-or-pay limited to state allowables. Full make-up rights for five years, refund in full if not made up.
8. Processing Rights: Tenneco/Conoco have all processing rights. Tenneco/Conoco bear all plant fuel and shrinkage.

E. Liquids extractions will be governed by agree-

ments covering all liquids arrangements, which provide for:

1. El Paso processes Tenneco/Conoco gas in El Paso's existing plants until a new cryogenic plant is built. El Paso will take 23% of the liquids as its fee for five years, and 28% after five years.

2. Tenneco/Conoco will build the new plant on a site provided by El Paso at its Blanco plant site, and upon completion will process their own gas and El Paso's. Tenneco/Conoco will take 39% of the liquids as their fee. The new plant will have a nominal design capacity of 500 MMcf/day.

3. The new plant will become the San Juan Basin base load plant, but all El Paso plants other than old Blanco will remain on stream.

4. El Paso will undertake to keep the new plant at nominal design capacity by delivering gas to fill capacity after Tenneco/Conoco volumes are delivered.

5. Tenneco/Conoco will install, at their sole cost, at least 10,000 H.P. of secondary compression in the new plant; El Paso will idle a reciprocating compressor now in operation.

F. Upon approval by the FERC of the settlement by final order no loner subject to judicial review, Tenneco and Conoco will each pay to El Paso $25 million, and El Paso will flow-through this $50 million settlement fund to its rate-payers in accordance with a Commission-approved plan.

G. After Commission approval of the settlement by final order no longer subject to judicial review, El Paso, Tenneco, and Conoco shall file with theSupreme Court a suggestion of mootness to reflect that a full and final settlement as between these parties has been reached. Such filing would be made in the event that the final

FERC approval not subject to judicial review preceeded this Court's decision on the merits if certiorari is granted.

H. During the pendency of the settlement before the Commission, neither El Paso, Tenneco, or Conoco will initiate new litigation with respect to GLA issues; each party retains the full right, however, to take such actions in existing or future cases as are necessary to preserve its procedural and substantive rights.

I. The Settlement Agreement may be terminated at any time prior to its effective date by mutual written consent of El Paso, Tenneco, and Conoco; by Tenneco and Conoco if the conditions precedent to the effectiveness of the settlement have not been satisfied within the earlier of (1) fifteen months after the date of execution of the Agreement or (2) 180 days after the date of a final order denying certiorari in the cases now pending before the Court; by El Paso if the conditions precedent to the effectiveness of the Agreement have not been satisfied within the earlier of (1) 15 months after the date of execution of the Settlement Agreement or (2) 30 days after the date of the final Decision of the Supreme Court of the United States reversing the Decision of the United States Court of Appeals for the Fifth Circuit in the pending Causes.

Nos. 83-1321, 83-1432, 83-1433, 83-1442, 83-1443 & 83-1618

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA, et al.,
Petitioners,

vs.

TENNECO OIL COMPANY, et al.,
Respondents.

On Petitions for Writs of Certiorari to the United States Court of Appeals For the Fifth Circuit

JOINT SUPPLEMENTAL MEMORANDUM OF PETITIONERS CALIFORNIA AND NEVADA CONCERNING PROPOSED SETTLEMENTS

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JOINT SUPPLEMENTAL MEMORANDUM OF PETITIONERS CALIFORNIA AND NEVADA CONCERNING PROPOSED SETTLEMENTS

I
INTRODUCTION

Pursuant to this Court's May 31, 1984 order, the People of the State of California and the Public Utilities Commission of the State of California ("California"), petitioners in No. 83-1321, and the Public Service Commission of Nevada ("Nevada"), a petitioner in No. 83-1432, hereby file this supplemental memorandum concerning the pending offer of settlement between petitioner El Paso Natural Gas Company ("El Paso") and respondents Tenneco Oil Company ("Tenneco") and Conoco Inc. ("Conoco"), as well as other settlements between parties in this proceeding. California and Nevada represent the ratepayers in their respective states, who rely heavily on the natural gas which El Paso transports to them from the San Juan Basin and are therefore greatly affected by any settlements pertaining to the future price and supply of this gas. Nevada also represents ratepayers in its state who rely on the natural gas which Northwest Pipeline Corporation ("Northwest") transports to them from the San Juan Basin.

Ever since 1974, after El Paso had unilaterally settled with the San Juan Basin natural gas producers ("the producers") as to the price it would pay for the special overriding royalties under the subject Gas Lease-Sale Agreements (GLAs), El Paso, California and some of the other petitioners herein have been litigating the jurisdictional issue which is presently before this Court.[1] Throughout the

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[1]The Federal Power Commission (predecessor to the Federal Energy Regulatory Commission ("the Commission"), allowed these settlement rates to be passed onto El Paso's customers, and ultimately the ratepayers in the western states who have been paying these overcharges throughout this litigation. In so doing, the Commission found it *significant* that in that settlement, El Paso had not given up its "best hope for relief from these special overriding royalty charges" since El Paso had maintained its right to continue litigating the jurisdictional question, and if El Paso were successful, the refund of these overcharges could be flowed back to the ratepayers. *El Paso Natural Gas Co.*, 57 F.P.C. 989, 990 (1977).

course of this jurisdictional litigation, settlement negotiations between El Paso and the producers have always included counsel for some of the petitioners herein, including California. Thus, for approximately ten (10) years, El Paso and the other petitioners have shared common ground in trying to prevent future gas prices under the GLAs from escalating significantly beyond proper regulation (and market-clearing prices), as well as in seeking refunds to ratepayers for past overcharges.

The present offers of settlement between El Paso and some of these producers sharply contrasts with this decade of previous cooperation and mutual interests between El Paso and the other petitioners herein. El Paso did not include any of the other petitioners in its settlement negotiations resulting in its agreement with respondent Union Oil Company of California ("Union").[3] Similarly, El Paso did not include any of the other petitioners in its settlement negotiations with Tenneco and Conoco. Instead, El Paso presented its offer of settlement (consisting of approximately 1000 pages) as a fait accompli to petitioners just before it filed its offer with the Commission. Initial comments on this offer of settlement, including requests for a hearing, are currently due at the Commission on July 2, 1984. Many

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[3]While this settlement agreement was in the context of El Paso's reassignment state court litigation in the District Court, 11th Judicial District, Harris County, Texas, many issues, such as the future price and supply of this gas, remain unresolved and may be the subject of the Commission proceeding on Union's certificate application in Docket No. CI84-141-000. Because this settlement may adversely affect El Paso's service to its customers, the Commission in its May 10, 1984 order required Union to make the settlement a part of the record. (See p. A-5 of the order in the attached appendix.) Notwithstanding the Commission's order, Union has not filed this settlement with the Commission and has refused to supply parties with a copy. While El Paso did furnish California with a copy of the settlement on June 7, 1984, we have not had sufficient time to analyze it for our filing with this Court.

of the petitioners herein intend to demand a hearing and the offer of settlement will be contested.

On the eve of this Court's conference to decide whether to grant certiorari in this case, El Paso, Tenneco and Conoco have brought to this Court's attention their offer of settlement, notwithstanding its lack of finality. These are the very companies (i.e., natural gas producers and a pipeline company) that Congress recognized must be regulated or else they would exploit consumers, *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 685 (1954), and they have entered into a settlement agreement with no participation or concurrence by the other petitioners, including those, such as California and Nevada, which represent the ratepayers. By its implication that this Court should deny certiorari (leaving final the decision of the court below) the untimely disclosure of the offer of settlement is a last ditch attempt to thwart the pricing protections that Congress had intended for all wholesales of natural gas in interstate commerce. Yet, the deliberate exclusion of the other petitioners, including those representing the ratepayers, from the settlement negotiations strongly indicates that the offer of settlement is not in the public interest. The only way to assure that the ratepayers in the western states will not be exploited by these companies is for this Court to grant certiorari and find that the Commission has jurisdiction over the subject lease-sales of natural gas.

II

THE COMMISSION CAN ONLY PROTECT THE PUBLIC INTEREST IF THIS COURT GRANTS CERTIORARI AND DETERMINES THAT THE COMMISSION HAS JURISDICTION OVER THE LEASE-SALES

Just as a court without subject matter jurisdiction is unable to assure a just resolution of a dispute, so too is the Commission unable to assure that the public interest will best be served in the present case unless and until this

Court grants certiorari and finds that the Commission has jurisdiction over the lease-sales in question. Consequently, it is realistic to expect that the Commission will await this Court's ruling on the Commission's jurisdiction before it finally determines whether the public interest supports the proposed settlements.

In the event that this Court finds that the Commission has jurisdiction, the Commission would have much more authority and alternatives in serving the public interest while reviewing the proposed settlements.[6] If the Commission has jurisdiction, we submit that it would not approve the present proposed settlements, because they are too detrimental to the western states ratepayers. Instead, the Commission could resume its remedy proceeding which had been close to trial before the court below issued its decision. The Commission's ability to protect the public interest is significantly circumscribed, however, if the decision of the court below is not reversed. Without Commission jurisdiction over the lease-sales, the producers would not be legally required to abide by any Commission decision except one approving the present offers of settlement under the terms, conditions and schedules dictated by the producers. Otherwise, the producers can walk away from these offers of settlement and attempt to triple their special overriding royalties on June 1, 1985, in which event El Paso has indicated it would then seek special relief to pass these costs onto the ratepayers.

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[6]The difference in how the Commission can review the proposed settlements depending upon whether it has jurisdiction is aptly demonstrated by its decision in *El Paso Natural Gas Co.*, 57 F.P.C. 989 (1977) when it passed the costs of the special overriding royalties onto the ratepayers. As the Commission informed this Court in its reply memorandum, "the Commission specifically stated that it was 'not deciding whether the amounts received by the special overriding royalty owners, *were they found to be jurisdictional*, are just and reasonable.' (57 F.P.C. at 1000)." [Emphasis added.] (FERC reply, pp. 7-8, fn. 7).

Without this Court's determination that the Commission has jurisdiction over the lease-sales, the Commission is powerless to order refunds by the producers for nearly a decade of overcharges to ratepayers in the western states. Tenneco and Conoco, whose GLAs account for approximately 70% of El Paso's natural gas involved in this case, have offered a total of $50 million in refunds in their proposed settlement, but this is a far cry from the $700 million which they would have to refund under California's and the Commission staff's theory of remedy. El Paso's "agreement" to this level of refund is preposterous, because the ratepayers have paid these overcharges since 1974 and El Paso is not authorized to settle the ratepayers' claim to these refunds.

In addition to this grossly inadequate level of refunds, the proposed settlements, if approved, would have severe effects on the future price and supply of the San Juan Basin natural gas for El Paso's customers. (See discussion, *infra.*) However, assuming *arguendo* that these offers of settlement are in the public interest and would not be devastating to the ratepayers, as we fear, the termination provisions of these settlements allow the producers to cancel the settlements under certain conditions which have already occurred or easily could occur. Under Union's and El Paso's settlement agreement, Union is already free to terminate the agreement, since the Commission has not yet issued Union a certificate of public convenience and necessity, and Union has an option to supersede this agreement with another one identical to the El Paso-Tenneco-Conoco offer of settlement.

Similarly, the El Paso-Tenneco-Conoco offer of settlement (pp. 24-25) provides:

"H. *Termination*

The Settlement may be terminated at the earlier of any of the following dates: (a) by either side if final

> Commission approval in a form satisfactory to such party has not issued within 15 months after the date of execution, (b) by Tenneco Oil and Conoco if such final approval has not issued within 180 days following denial of certiorari in the litigation now pending before the Supreme Court, and (c) by El Paso, if such final approval has not issued within 30 days following the final reversal of the decision in *Sun Oil, supra.* In addition, if the orders are unacceptable, any of the parties have the right to terminate the Settlement Agreement.
>
> Because the right to terminate arises in the event that the approvals are no longer subject to judicial review, expeditious consideration by this Commission is necessary to assure that approvals become final before the termination rights arise."

Under this agreement, if this Court denies certiorari, the Commission has only 180 days (really 150 days if one subtracts the 30-day period for filing petitions for rehearing) to finally approve the settlement. If any party opposes it or if it cannot be decided within 150 days because, for example, the producers are not cooperative in discovery, then Tenneco or Conoco can terminate the agreement. They can also terminate the agreement if the Commission's order is unacceptable.

Thus, if this Court denies certiorari, the producers are in absolute control of their settlement proposal. Tenneco and Conoco can dictate the time for discovery, hearings, briefing schedules, and the Commission's issuance of the decision on this settlement and even the form of the Commission approval of it. Of course, if the Commission denies the settlement or any party appeals the Commission's approval of it, the settlement can be terminated.

Clearly, this case is far from being settled. With Union able to presently terminate its agreement (and withdraw

its certificate application) and Tenneco and Conoco able to easily walk away from their offer of settlement, these are only, at best, possibilities of offers of settlement and they should not dissuade this Court from granting certiorari. It is certainly foreseeable that after having informed this Court of the alleged virtues of their proposed settlements, that in the event that this Court denies certiorari, the producers may ultimately terminate their settlement agreements and forever keep their lease-sales nonjurisdictional. The only way that the Commission can truly protect the public interest is by having jurisdiction over the subject matter while considering the settlement proposals.

III
THE RATEPAYERS FACE OMINOUS ALTERNATIVES IF THE PRODUCERS ESCAPE REGULATION THROUGH THIS COURT'S DENIAL OF CERTIORARI

Besides losing their opportunity to seek refunds for over $1 billion for past overcharges, the ratepayers in the western states face potentially severe prospective gas prices and/or supply impacts if this Court does not reverse the decision of the court below.

The proposed settlements between El Paso and Union (concerning approximately 14% of El Paso's gas in question) and El Paso and Tenneco and Conoco (concerning approximately 70% of El Paso's gas in question) can best be understood in the context in which they were entered. After El Paso implemented this Court's *Mid-Louisiana* decision, *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, ... U.S. ......, 103 S.Ct. 3024, 77 L.Ed. 2d 668 (1983), which limited El Paso to Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. § 3301, *et seq.*, ceiling prices, it unsuccessfully sought in Harris County, Texas state court litigation to reassign the properties burdened by the special overriding royalties, which exceeded the applicable NGPA ceiling prices. During this litigation, Union vol-

untarily accepted reassignment, and in the Commission's proceeding on Union's certificate application (Docket No. CI84-141-000), Union seeks Section 109 pricing (15 U.S.C. § 3319) under the NGPA for old gas, which would more than double the price El Paso's customers currently pay for this gas, and would be more than four times the proper price of this gas (NGPA Section 104 flowing gas, 15 U.S.C. § 3314) if the Commission has jurisdiction over the lease-sales.

In the Commission proceedings, petitioners will for the first time have the opportunity to learn the full impacts of the settlement agreement between Union and El Paso. We are unable to detail them at this time, since we did not receive a copy of it until June 7, 1984 and have not yet had an opportunity to conduct discovery. However, in addition to the proposed increase in rates if Union receives the Section 109 pricing, we already recognize that western states ratepayers will be adversely affected by at least two of the provisions in Union's proposed gas purchase contract. First of all, El Paso has previously received revenues from its extraction of liquid hydrocarbon products ("liquids") from the gas under the GLAs. El Paso has credited these revenues to its cost of service thereby reducing the rates its customers must pay. In this proposed gas purchase contract, El Paso agrees to transfer 77% of the liquids revenues from El Paso's customers (and therefore ratepayers) to Union. Thus, El Paso's rates would increase due to the transfer of ownership of these liquids. Secondly, Union has a right to retain up to 25 % of the gas produced from new wells on these properties. Thus, in the event of any gas shortage in the future, El Paso's customers in the western states would be threatened by this reduction in El Paso's gas supply.

Tenneco and Conoco did not enter into their settlement agreement with El Paso until after they won the state court litigation and thus had even more leverage than Union in its settlement with El Paso. We are informed and believe

that after the state court's ruling, counsel for Tenneco and Conoco stated publicly to the press that the special overriding royalties could amount to $6 billion over 20 years.[4] Thus, this current offer of settlement where they have given up the right to collect these royalties would, undoubtedly, generously compensate the producers, and we fear this will be at the ratepayers' expense.

While petitioners need extensive discovery in the Commission proceedings to ascertain the full impacts that would occur if this proposed settlement is approved, we already recognize that western states ratepayers will be adversely affected in the future, besides losing over 90% of the refunds they should receive. Like the Union agreement, Tenneco and Conoco have reserved up to 25% of the new gas from these properties which would be a severe curtailment in El Paso's gas supply in the event of a gas shortage. Also, rates for old gas would more than double for the next two years and thereafter would fall under the interstate rollover rates under Section 106(a) of the NGPA, 15 U.S.C. § 1316(a), (currently priced at 89¢/MMBtu), whereas under proper regulation, the price should be approximately half of that according to the flowing gas rates of Section 104 of the NGPA, 15 U.S.C. § 3314, (currently priced at 49¢/MMBtu), if the Commission has jurisdiction over these lease-sales.

Most significantly, California and Nevada are apprehensive that western states gas consumers could face substantial increases in their rates from El Paso's transfer of liquids revenues from the ratepayers to Tenneco and Conoco. Similar to the Union agreement, El Paso has transferred at least 77% of its revenues for liquids from the

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[4]See *Houston Post* March 1, 1984 story in the appendix (p. A-8) attached hereto. We are informed and believe that even this $6 billion figure does not include the tripling of special overriding royalties on June 1, 1985 that the producers may seek under the 1974 settlement agreement.

GLA properties to Tenneco and Conoco. In addition, under the proposed settlement El Paso would amend approximately 100 other San Juan Basin gas purchase contracts with Tenneco and Conoco and would transfer all of its liquids revenues from those properties (which were not even part of this litigation) from ratepayers to Tenneco and Conoco. Additionally, with the producers' incentive to extract as much liquids as possible, the gas they supply to El Paso will contain less Btus, further threatening future gas supplies, and much of this gas is low-cost old gas which would have to be replaced, if it can be, by more expensive new gas. Through discovery we could learn the full amounts and impacts involved. In view of the fact that these producers settled with El Paso at a time when they had the most leverage over El Paso, and that they deliberately excluded all of the other petitioners from these negotiations, we have reason to believe that this impact could be enormous.

Unless this Court grants certiorari and reverses the decision of the court below, western states ratepayers face dismal alternatives. Absent a jurisdictional finding by this Court, El Paso has represented that it will seek from the Commission special relief to pass onto its customers (and ratepayers) the exorbitant costs it must pay to the *unregulated* producers. On the other hand, if El Paso's proposed settlements with certain producers are approved by the Commission, El Paso's customers and ratepayers still face substantial rate increases and risk a curtailment in their future gas supply. Moreover, these settlements do not apply to all of El Paso's or Northwest's gas produced under the GLAs and PLAs.[5]

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[5]El Paso has not settled with producers of 15% of its gas in question. We are informed and believe that Northwest, which is in a similar predicament as El Paso, has not settled with producers of over 25% of the gas it receives under its Pacific Lease-Sale Agreements ("PLAS") and its special overriding royalties could more than double on June 1, 1985.

El Paso, Northwest, their customers and the western states ratepayers are entrapped in a no-win situation due to the producers' current success in escaping from the regulations which Congress intended to govern wholesales of interstate gas. Unless this Court reviews this matter and reverses the decision below, the Commission is relatively powerless to prevent this exploitation, and the pipeline companies, their customers, and the western states ratepayers are at the mercy of the producers.

IV
CONCLUSION

For the foregoing reasons, this Court should grant the petitions for writs of certiorari.

Dated: June 12, 1984

Respectfully submitted,

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(Appendices follow)

Appendix A

United States of America
Federal Energy Regulatory Commission

Hearing

Before Commissioners: Raymond J. O'Connor, Chairman; Georgiana Sheldon, J. David Hughes, A. G. Sousa and Oliver G. Richard III.

Union Oil Company of California Docket No. CI84-141-000
Order Providing for Hearing

(Issued May 10, 1984)

Union Oil Company of California (Union) has filed an application for a certificate of public convenience and necessity authorizing Union to sell gas to El Paso Natural Gas Company (El Paso) from its interest in certain leases in the Basin Dakota, Mesa Verde Blanco, South Blanco and Ballard Pictured Cliffs Fields, San Juan and Rio Arriba Counties, New Mexico. El Paso is the predecessor in interest to the properties from which the sale will be made.

Union's application follows an agreement to settle certain disputes between El Paso and Union regarding their future relationship with respect to the leases in question. These disputes initially involved the level of overriding royalties payable to Union under three lease agreements (GLAs 76, 348 and 349) entered into in 1953 and 1958. The court recently held that these lease agreements, among others, were not subject to this Commission's jurisdiction under the Natural Gas Act.[1] El Paso thus remained obli-

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[1] *El Paso Natural Gas Co. v. Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983). A petition for a writ of certiorari was filed with the United States Supreme Court by the Commission on April 2, 1984, in *FERC v. Tenneco Oil Company, et al.*

gated under the 1974 amendments to the three lease agreements to pay Union an overriding royalty equal to the highest price of general applicability in the San Juan Basin area less seven cents per Mcf. Since passage of the Natural Gas Policy Act of 1978 (NGPA), El Paso has interpreted these amendments as entitling Union to collect for its overriding royalty interest the NGPA Section 102 price less seven cents per Mcf. This interpretation has been applied by El Paso, even though El Paso, itself, may be limited for gas produced from some of the properties to prices below the Section 102 price.

Following the decision in *Public Service Commission v. Mid-Louisiana Gas Co.*, 51 U.S.L.W. 5030 (June 28, 1983), where the Court held that gas produced by a pipeline is subject to the first sale pricing provisions in the NGPA, El Paso sought to convey the properties covered by the three lease agreements to Union. El Paso also filed a petition for declaratory order in the District Court of Harris County, Texas, naming Union as a defendant, as well as other producers who had overriding royalties in other lease agreements.[2] El Paso claimed there that the *El Paso* and *Mid-La* decisions had made the wells on the properties in question unprofitable to operate and non-commercial and attempted to invoke provisions in GLA 76 that allegedly empowered it unilaterally to reassign these wells to Union effective October 1, 1983.[3] In response Union denied El Paso's right unilaterally to reassign the wells.

El Paso also filed a petition with this Commission in Docket No. CI83-356-000 requesting, *inter alia*, an order

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[2]*El Paso Natural Gas Co. v. Tenneco Oil Co., et al.*, Docket No. 83-50539. In a memorandum opinion issued February 15, 1984, the Court denied El Paso's petition.

[3]GLAs 348 and 349 do not contain such a provision, and with respect to these agreements El Paso tendered reassignment, subject to Union's acceptance.

requiring Union to seek certificate authorization for the sale by Union to El Paso of gas produced from the properties it had allegedly reconveyed. Union in its petition to intervene in that case denied El Paso's right unilaterally to reassign any of the properties and contended that it was not required to seek a certificate.

Union and El Paso on November 11, 1983, resolved their dispute concerning reassignment of the subject properties. They have agreed that upon receipt of a certificate satisfactory to Union authorizing it to sell gas to El Paso, Union will accept voluntarily reassignment of the properties effective as of October 1, 1983. As a result of the settlement, Union was dismissed as a defendant in the Harris County litigation.

The gas purchase agreement which will govern the sale of gas by Union to El Paso covers gas produced from Union's interests in the subject properties. It requires El Paso to take or pay for on an annual basis 50% of Union's deliverability, but in no case less than ratably with other producers in the area. The agreement further provides that El Paso shall pay the maximum lawful price applicable to the gas under the NGPA, except that for gas subject to NGPA Section 107(c)(5), the price shall not exceed the NGPA Section 102 ceiling.

Union states that it will charge the NGPA Section 108 price for stripper well gas and the NGPA Section 102 price for gas qualifying under NGPA Section 107(c)(5). For the remainder of the gas Union claims the right to charge the ceiling prescribed in NGPA Section 109. As to such gas Union asserts that it was committed or dedicated to interstate commerce prior to the enactment of the NGPA but was not subject to a just and reasonable rate set by the Commission.

After due notice by publication in the *Federal Register* on December 29, 1983 (48 Fed. Reg. 57364), timely petitions

to intervene were filed by Southern California Gas Company (So Cal), Pacific Gas and Electric Company (PG&E), The People of The State of California and The Public Utilities Commission of The State of California (California), El Paso Natural Gas Company (El Paso), Southern Union Gas Company, Gas Company of New Mexico, Southwest Gas Corporation (Southwest) and Tenneco Oil Company, Conoco Inc., *et al.*[4] An untimely petition was filed by Northwest Pipeline Corporation (Northwest). Good cause exists to grant Northwest's petition to intervene in the instant proceeding.

So Cal, PG&E, California, and Southwest in their petitions have indicated disagreement with Union's position that it is entitled to the NGPA Section 109 price. So Cal, PG&E and California have requested a formal hearing. PG&E, as a possible alternative, has suggested an informal conference. El Paso in its petition takes no position with respect to Union's price, but it does suggest that if the price becomes a disputed issue, it would involve a question of law which can best be addressed by the submission of written arguments.

In addition to the Section 109 price question, there is also a need to resolve one other issue before any certificate can be issued to Union. Specifically, the various provisions in the settlement between El Paso and Union concerning the transfer of the subject properties should be explored in this certificate case. While the settlement has not been submitted to this Commission for its approval, we think it important for us to ascertain how the settlement affects El Paso's customers and whether it is in the public interest to grant Union authorization in light of the settlement provisions.

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[4]These interventions have been granted by operation of Rule 214.

The transfer of the subject properties to Union may constitute a change in the service previously rendered by El Paso. Union's application should, therefore, be evaluated in the context of not only the changes on Union but also the types and extent of changes on El Paso. If Union is to be authorized to acquire the properties and sell gas from the properties, a satisfactory showing of consistency with the overall public interest will be required. This is important because a satisfactory showing made in this subject proceeding would constitute a presumption of prudence in implementing the provisions of the settlement in El Paso's jurisdictional rates. In this regard, Union and El Paso shall be required to demonstrate that the settlement provisions are in the public interest. In addition, Union shall make the settlement a part of the record in this case.

In view of the foregoing, it is necessary to set this matter for hearing. Because of the complex nature and certain unique features of the application, the Commission believes that a prehearing conference involving all the parties and the staff should be convened at an early date. The express purpose of that conference would be for delineating issues of concern by the various parties and determining issues which may be resolved by agreement and issues which may require legal briefing or formal hearings.

Union has suggested in its certificate application that there is no need to resolve herein the question of whether El Paso should obtain abandonment authorization under Section 7(b) of the Natural Gas Act before it reassigns the properties to Union. We agree. Union has voluntarily agreed to the reassignment and has applied for certificate authorization. El Paso is an intervenor in this case and will be required to show that the settlement with Union is in the public interest. The Commission will thus have available all of the information necessary to determine whether Union's proposed sale is required by the present or future public convenience and necessity.

The Commission finds:

The public interest requires that this case be set for formal hearing.

The Commission orders:

(A) Pursuant to the authority of the Natural Gas Act, particularly Sections 4, 5, 7, 8, 14, 15, and 16, and the Commission's rules and regulations, a public hearing shall be held in the above-entitled proceeding.

(B) A Presiding Administrative Law Judge shall be designated by the Chief Administrative Law Judge (18 C.F.R. § 385.304), to preside over this proceeding in a hearing room of the Federal Energy Regulatory Commission, 825 North Capitol Street, N. E., Washington, D. C. 20426. A prehearing conference shall be convened at an early date for the express purpose of delineating issues of concern by the various parties and determining issues which may be resolved by agreement and issues which may require briefing or formal hearings. The Presiding Administrative Law Judge is authorized to establish such further proceedings in accordance with this order and the Rules of Practice and Procedure.

(C) Northwest is permitted to intervene in this proceeding subject to the rules and regulations of the Commission; *Provided,* however, that the participation of such intervenor shall be limited to matters affecting asserted rights and interests as specifically set forth in its petition to intervene; and *Provided, further,* that the admission of said intervenor shall not be construed as recognition by the Commission that it might be aggrieved because of any order of the Commission entered in this proceeding.

By the Commission.

(SEAL)

/s/ Kenneth F. Plumb
Kenneth F. Plumb,
Secretary.

Appendix B

Houston Post,
March 1, 1984, p. 1F

El Paso
to appeal
gas case
By Sam Fletcher
Post Energy Writer

El Paso Natural Gas Co. said Wednesday it plans to appeal its loss in an unique natural gas case described as the largest ever tried.

The ruling involves royalty payments which some say would amount to $6 billion over a 20-year period and $2 million in attorneys' fees for the 84 winning defendants.

Judge William N. Blanton Jr. of the 11th District Court of Harris County entered final judgment Wednesday denying El Paso's efforts to transfer ownership of natural gas leases in an effort to avoid those royalty payments which company officials said made those wells unprofitable.

3,200 wells

Involved were 3,200 wells in the San Juan Basin of New Mexico.

Robert J. King of Liddell, Sapp, Zively, Brown & LaBoon, the law firm representing El Paso, said the company filed the suit in 1983 against Tenneco Oil Co., Conoco Inc. and other defendants because it is losing $50 million a year on production from those leases.

King said the controversy began with a June 1983 ruling by the Supreme Court which for the first time applied the same federal price limitations on gas wells owned and operated by pipeline companies as those wells not owned by pipelines.

Because the series of contracts involving the San Juan Basin leases date back to 1952-1953, King said, some of that gas is priced at 85 cents per thousand cubic feet (Mcf) with the remainder in the range of $2.50 Mcf.

However, he said, the contracts provide for overriding royalties amounting to $3.25 per Mcf to be paid to the defendants. Because the company couldn't sell its gas for as much as the overriding royalties, he said, El Paso is losing $50 million annually.

"If the gas bubble disappears and production increases, the corresponding loss could approach $100 million a year," he said.

For that reason, he said, El Paso filed suit last August seeking relief under a provision of the contracts which allowed it to turnback unprofitable wells.

"The company thought it could give the properties back to the clients to eliminate having to pay royalties, and then purchase the gas from them at the regulated price," said Diana E. Marshall, a partner at Baker & Botts who represented most of the defendants, including Tenneco and Conoco.

She said those royalties would total about $6 billion over a period of 20 years.

Amounts not considered

In his ruling, Blanton said the lease sale agreements do not take into account the amounts of either royalties or gas prices in determining the profitability of a well.

"He construed the contract language to mean that the wells are not unprofitable in the normal sense," King said. "The judge only looked at the operational costs."

King said the wells, which are dedicated to interstate markets primarily in Arizona and California, will continue

producing. He said, "It is one of the most substantial gas fields in the nation."

Because of the unique nature of this case, both sides said it will have no impact on other natural gas contracts or prices.

"We're told this is the largest case ever tried," Marshall said. "Other suits may have been filed that initially asked for more money, but this is supposed to be the biggest amount of money and controversy ever disposed of by a trial judge."

No. 83-1618

In the Supreme Court of the United States

OCTOBER TERM, 1983

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

TENNECO OIL COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

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TABLE OF AUTHORITIES

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REPLY MEMORANDUM FOR THE PETITIONER

In our petition, we contended that the decision of the court of appeals—holding that the lease sale agreements at issue are not subject to Commission regulation under the Natural Gas Act, 15 U.S.C. 717 *et seq.*—constitutes a clear departure from the fundamental teachings of this Court in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), and *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965) (*Rayne Field*). We also argued that, unless the decision below is reversed, respondents would

reap an enormous windfall—at the expense of the pipelines and/or their customers—for many years to come.[1] The points raised by respondents warrant only a few brief comments.

1. It is common ground that, in determining whether the Commission has jurisdiction over lease sale agreements, the dispositive question is whether what was sold was gas reserves or merely the right to explore for gas. Respondents contend (PLA Resp. Br. in Opp. 14; Tenneco Oil Br. in Opp. 12-13) that under *Rayne Field*, "substantiality of development" is an absolute prerequisite to a finding of Commission jurisdiction. We disagree. The central teaching of *Rayne Field*, which respondents ignore, is that the jurisdictional question turns on the overall economic and commercial realities of the transaction, not on application of a rigid, mechanistic formula.

Viewed in these terms, the lease sale transactions at issue must be regarded as subject to the Commission's jurisdiction. As we demonstrated in our petition (at 19-20), the economic realities support the Commission's conclusion that the respondent gas producers were not leasing the right to explore land for gas but were selling gas in place. The record convincingly shows that the producers sold proven gas reserves[2] for resale in interstate commerce pursuant

[1] For example, the GLA respondents are presently receiving "royalties" of about $3.50 per MMBtu—a rate that exceeds by more than 400% the current NGPA price for "old" or "flowing" gas. As we explain below (see note 5, *infra*), this rate could almost triple by next year.

[2] Where lease sale acreage is proven, the economic reality is that gas, not exploration rights, is being sold. The court of appeals in this case acknowledged (Pet. App. 15a) that "the record reveals the reserves in the [San Juan] Basin may well

to contracts that were similar in substance to conventional wellhead sales contracts.[3] Moreover, these reserves were sufficiently developed to permit the two pipeline companies to obtain the regulatory approval and financial commitments necessary to construct major segments of their pipelines.[4] In short, "[t]he

have been 'proven' at least within reasonable estimates." As the ALJ observed, the particular geological structure of the Basin "tended to assure that gas would be encountered at virtually any location" (Pet. App. 53a (footnote omitted)). The ALJ cited the testimony of a witness for Northwest, who stated that the pipeline had drilled several hundred wells in the Basin and had never encountered a dry hole (*id.* at 53a n.47).

[3] The contracts provided for: (1) a specified sum per Mcf subject to periodic escalation; (2) rate redetermination at the end of a fixed term; and (3) favored nations clauses and take-or-pay clauses. In addition, the contracts imposed strict drilling requirements on the pipelines.

[4] To be sure, the San Juan Basin fields here involved were not as developed as was Rayne Field. As we explained in our petition, however, under the practical approach applied in *Continental Oil Co.* v. *FPC*, 370 F.2d 57 (5th Cir. 1966), cert. denied, 388 U.S. 910 (1967) (*Ship Shoal*), the fields here certainly "reached the stage of proof and development necessary to satisfy the *Rayne* criteria" (370 F.2d at 64).

In an effort to distinguish this case from *Ship Shoal*, respondents argue (Union Oil Br. in Opp. 19-21; PLA Resp. Br. in Opp. 19-21) that the field in *Ship Shoal* was substantially developed, whereas the fields involved in the instant lease sale transactions were not. Respondents' argument is wide of the mark. At the time of the transfer in *Ship Shoal*, only two of the estimated 36 to 42 completions needed to develop the field for gas production were in place. Of the twelve wells that had been drilled, only one was a gas well; the others were oil wells or dry holes. The subsequent drilling of five potential gas wells to which respondents refer (PLA Resp. Br. in Opp. 20) was done by the pipeline purchasers (following closing), not by the producers. See *Ten-*

crucial fact here, as in *Rayne*, is that the assignment of the leases accomplished the transfer of large amounts of substantially proven * * * gas reserves to an interstate pipeline for eventual resale in interstate commerce * * *." *Ship Shoal*, 370 F.2d at 67.

By contrast, respondents' analysis defies economic reality. As we pointed out in our petition (at 7 n.9, 16), the special overriding royalties involved here, which are payable on the net interest assigned (as in *Rayne Field* and *Ship Shoal*), are about six to seven times greater than typical land owner royalties (70%-80% v. 12½%). Respondents do not explain why this "royalty" level is so high if, under their theory of the case, the transactions merely involved the right to explore otherwise worthless land for gas. Moreover, respondents' theory rests on the wholly invalid assumption that the Commission and the financial community would approve major pipeline construction solely on the basis of exploration rights. The simple economic reality is that these transactions involved the sale of natural gas reserves in place.

2. Respondents contend (PLA Resp. Br. in Opp. 16-19; Union Oil Br. in Opp. 10-11) that the decision below can have no prospective impact on natural gas consumers because, under this Court's decision in *Public Service Commission* v. *Mid-Louisiana Gas Co.*, No. 81-1889 (June 28, 1983), the rates charged by

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nessee Gas Transmission Co., 30 F.P.C. 759, 798, 803 (1963). Respondents' submissions to this Court overstating the level of development in *Ship Shoal* stand in sharp contrast to the producers' petition for a writ of certiorari in *Ship Shoal*, in which the producers stated that "only one gas well had been completed, no gas had been produced, and at the time of transfer 34 to 40 completions were anticipated for development" (*Continental Oil Co.* v. *FPC*, petition for cert., No. 1323, at 6 (Oct. Term, 1966)).

El Paso and other pipelines for first sales of pipeline-produced gas may not exceed the applicable ceiling rates in Title I of the Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.* (NGPA). On the contrary, we submit that the future ramifications of this one case alone are themselves sufficiently substantial to warrant certiorari.

Respondents do not dispute the assertion in our petition (at 22) that the lease sale acreage involved in this case presently contains estimated reserves of approximately three trillion cubic feet of gas. In addition, the GLA respondents cannot dispute that, at present, they are receiving "royalty" payments of more than $3.50 per MMBtu for "old" natural gas, the current NGPA ceiling price for which is well under $1.00 per MMBtu. Nor do respondents dispute that this approximate "400% monetary gap" will widen as the remaining reserves are utilized in future years.[5] Rather, respondents assert (Union Oil Br. in Opp. 14-15; Tenneco Oil Br. in Opp. 24-26) that the impact of the "400% monetary gap" will fall on the pipelines, not the consumers—a consequence that, respondents suggest, does not justify review by this Court.

To be sure, as we acknowledged in our petition (at 21) and as respondents emphasize (Union Oil Br. in Opp. 10-11; PLA Resp. Br. in Opp. 18-19;

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[5] The 400% differential between the "royalty" being paid respondents and the NGPA ceiling price for the gas may be dwarfed by future differentials. In June 1985, following the scheduled deregulation of new gas under the NGPA (see 15 U.S.C. 3331(a)(1)), El Paso will be required to pay royalties to respondents based on the average of the three highest prices the pipeline pays for gas. At that point, the 400% differential could almost triple.

Tenneco Oil Br. in Opp. 9-10), the decision whether to shift financial responsibility from the pipelines to the ultimate consumers through special rate relief is a matter within the ultimate discretion of the Commission. See 15 U.S.C. 3314(b)(2); *FERC* v. *Pennzoil Producing Co.*, 439 U.S. 508 (1979). But respondents miss the point when they assert simplistically that the Court should not be concerned about the adverse future impact of the decision below because the financial fallout may fall on the pipelines rather than on the ultimate consumers. Respondents' argument is based on an unduly restrictive view of the scope of the Commission's responsibility to protect the public interest under both the Natural Gas Act and the NGPA. The "public interest" over which the Commission stands watch encompasses all segments of the natural gas industry—consumers, distributors, state commissions, pipelines and producers. See, *e.g.*, *NAACP* v. *FPC*, 425 U.S. 662, 669-670 (1976). As the court pointed out in *Consumer Federation of America* v. *FPC*, 515 F.2d 347, 357-358 (D.C. Cir.), cert. denied, 423 U.S. 906 (1975), this Court has consistently rejected the notion that the Commission need not concern itself with the level of producer rates "on the ground that the pressures built up by producer rate increases could somehow be contained at the pipeline level by invoking a regulatory agency's authority to disallow 'excessive' costs." It is clear that either the pipelines or the ultimate consumers will suffer severe financial dislocation absent reversal of the court of appeals' erroneous decision.[6]

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[6] Respondents' attempt to cast the impact of the court of appeals' decision on future gas prices as essentially a private dispute between themselves and El Paso (*E.g.*, Union

In our petition (at 20-21), we pointed out that if the Commission is held to have jurisdiction, gas consumers would be able to assert claims for more than $1 billion in refunds for the special overriding royalties paid to respondents in the period between 1974 and 1983.[7] Respondents, not surprisingly, dispute

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Oil Br. in Opp. 14-15) is misleading. In order to mitigate the enormous future impact of the decision below on the pipelines, both El Paso and Northwest have entered into settlements with some of the respondents. The settlement between Northwest and Phillips has already been approved by the Commission. In approving that settlement, the Commission noted that "Phillips is offering to accept rates under PLA-5 that could save Northwest, *and eventually its consumers*, as much as $50 million a year." *El Paso Natural Gas Co.*, 25 F.E.R.C. ¶ 61,292, at 61,674 (1983) (emphasis added). The settlements between El Paso and Union (*Union Oil Co. of California*, Docket No. CI84-141-000 (filed Dec. 13, 1983)) and between El Paso and both Tenneco and Conoco (*El Paso Natural Gas Co.*, Docket No. CP74-314, *et al.* (filed May 18, 1984)), which have not yet been approved by the Commission, raise numerous complex issues relating to future gas cost and gas supply.

With regard to the impact of the decision below on the pipelines, respondents' argument (Union Oil Br. in Opp. 14-15; Tenneco Oil Br. in Opp. 24-25) that application of *Mid-Louisiana* to the El Paso system will be beneficial to the pipeline overall is wholly irrelevant. The fact that El Paso is entitled, under *Mid-Louisiana*, to additional revenues for its production from other properties has no bearing on whether the lease sale transactions at issue are subject to the Commission's jurisdiction and, if so, whether the rates paid by El Paso to respondents for the gas are unjust and unreasonable.

[7] Respondents erroneously suggest (Tenneco Oil Br. in Opp. 22-23) that the Commission, in *El Paso Natural Gas Co.*, 57 F.P.C. 989 (1977), approved the level of these special overriding royalties as being just and reasonable. The Commis-

these claims (Union Oil Br. in Opp. 12-14; PLA Resp. Br. in Opp. 25-27).[8] It is clear, however, that unless the court of appeals' decision is overturned, the affected natural gas consumers would be deprived of any opportunity to assert their refund claims.

For the foregoing reasons and those stated in our petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

REX E. LEE
Solicitor General

MAY 1984

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sion simply held that El Paso had acted prudently in entering into settlements after the Sun Oil arbitration award. Indeed, the Commission specifically stated that it was "not deciding whether the amounts received by the special overriding royalty interest owners, were they found to be jurisdictional, are just and reasonable" (57 F.P.C. at 1000).

[8] Even if there were merit to respondents' assertion that refunds should not be ordered for the period prior to September 25, 1980 (the date of the Commission's decision on jurisdiction), a point we do not concede, refunds of nearly half a billion dollars have been claimed for the period subsequent to that date.

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Nos. 83-1321, 83-1432, 83-1433,
83-1442, 83-1443 & 83-1618

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

JOINT REPLY BRIEF IN SUPPORT OF PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

Nos. 83-1321, 83-1432, 83-1433,
83-1442, 83-1443 & 83-1618

THE PEOPLE OF THE STATE OF CALIFORNIA, *et al.*,
Petitioners,

v.

TENNECO OIL COMPANY, *et al.*,
Respondents.

JOINT REPLY BRIEF IN SUPPORT OF PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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1. The Public Importance Of This Case

Producers' principal defenses are that the case is "prospectively moot" because gas consumers (as opposed to the pipelines) face no risk of future exploitation and that refunds to consumers for exploitation in the past are uncertain. These defenses are without merit.[1]

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[1] Producers also contend that the GLA/PLA transactions are *sui generis*. There is no evidence in the record, however, that the GLA/PLA transactions, along with the lease sales found jurisdictional in the 1960s, are the entire universe of jurisdictional lease sale transactions. An assertion to that effect would be incorrect.

Mid-La[2] did not change the statutory duty of the FERC[3] under the NGA[4] or the NGPA[5] to regulate sales of gas by producers. *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 394 (1974) ("No producer is exempt from §§ 4 and 5."). Indeed, the protection of gas consumers from exploitive prices requires that the FERC regulate the producer as well as the pipeline. "Control limited to approving the costs of the gas to the purchasing pipeline is, of course, not an effective way to regulate producer prices because in the large a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities." *Texas Eastern Transmission, Corp.*, 29 F.P.C. 249, 255-56 (1963) (FPC's *Rayne Field* decision). "Throughout the years in controversies such as *Phillips* and *CATCO*, the FPC has sought to justify inaction at the level of producer rates on the ground that the pressures built up by producer rate increases could somehow be contained at the pipeline level by invoking a regulatory agency's authority to disallow 'excessive' costs. And throughout the years, the [Supreme] Court has found this professed substitute inadequate." *Consumer Federation of America* v. *FPC*, 515 F.2d 347, 357-58 (D.C. Cir.), *cert. denied*, 423 U.S. 906 (1975). According to this Court, ". . . rates are 'just and reasonable' only if consumer interests are protected and if the financial health of the pipeline in our economic system remains strong." *FPC* v. *Memphis, Light, Gas & Water Div.*, 411 U.S. 458, 474 (1973).

If the decision below is not reversed, the GLA producers and the non-settling PLA producers will long continue to reap windfalls never contemplated by Congress under the NGA or the NGPA. Moreover, El Paso anticipates that the GLA producers, unless restrained by regulation, will contend that their special overriding royalty should just about *triple* on and after

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[2] Public Service Comm'n of New York v. Mid-Louisiana Gas Co., 103 S. Ct. 3024 (1983).

[3] Federal Energy Regulatory Commission.

[4] Natural Gas Act, 15 U.S.C., §§ 717-717w (1982).

[5] Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1982).

June 1, 1985. It is obvious that El Paso will ask gas consumers to shoulder the impact of such a dramatic escalation of an already excessive payment.[6] On Northwest's system, Phillips and Getty have accepted regulated prices, under settlements approved by the FERC, but the other PLA producers (Amoco, Atlantic, Mobil) like the GLA producers claim that they should receive several times more than these maximum lawful prices. If Northwest is required to pay these excessive demands, it will have no alternative but to seek from the FERC special relief permitting it to pass these payments onto ratepayers.

Accordingly, if the Court of Appeals opinion stands, its economic impact will extend far into the future. There are still

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[6] The representation of Tenneco, *et al.* of no prospective consumer impact is disingenuous. In the Texas state court litigation, Tenneco's expert testified that "El Paso would have an excellent chance of having [special relief] granted . . . ." El Paso Natural Gas Co. v. Tenneco Oil Co., No. 83-50539, 11th Judicial District, Harris County, Texas, transcript of January 26, 1984, p. 105. The Commission in approving the Phillips-Northwest PLA 5 settlement (discussed in the text, *infra*), noted that "Phillips is offering to accept rates under PLA 5 that could save Northwest, *and eventually its consumers*, as much as $50,000,000 a year." 25 FERC ¶ 61,292 at 61,674 (1983) (italics added). Thus, the FERC recognized that it is uncertain that the pipelines will bear the entire cost of high special overriding royalties in the future if the GLA/PLAs are not jurisdictional sales. The producers point out that El Paso presently offsets GLA production losses against profitable production on non-GLA properties. Producers' contention is irrelevant; the fact that El Paso has other profitable operations in no way justifies producers' continuing receipt of unregulated revenues in violation of the NGA and NGPA. Producers in their argument that El Paso and not the consumers can bear the future impact cite a study prepared for a different purpose by El Paso's reservoir engineering department. The study did not take into account the dramatic increase in the special overriding royalty that producers will seek after June 1, 1985. As of this time, El Paso has not sought special relief, but, contrary to the assertion in Tenneco's Brief at 10 n.19, El Paso's witnesses did *not* testify in the Texas state court case that the FERC would likely deny special relief if reassignment failed. (They testified that the FERC would likely deny special belief so long as El Paso had reassignment rights which it could exercise—rights which the state court subsequently said could not be exercised.) The only way to ensure that the consumer does not face substantial increased costs in the future is through a jurisdictional decision in this case.

some 3 trillion cubic feet of gas under the GLA/PLA leases,[7] and production from these leases, burdened with high special overriding royalties allowed under the Fifth Circuit's decision, will continue for 20 years or more. The FERC, required to protect both gas consumers and the legitimate interests of pipelines, will be confronted with unsatisfactory choices for either, guaranteeing endless litigation.

Producers try to minimize the amount of the refunds claimed in the FERC remedy proceeding, but it is obvious that the producers have been paid far more than they should have been paid in the past. If the decision below is reversed, petitioners will have the opportunity in an FERC remedy proceeding to prove that the GLA producers must refund more than $1 billion for the benefit of gas consumers on El Paso's system and, excluding Phillips and Getty, $50 million for Northwest's consumers.[8] Producers assert that these refund claims are exaggerated, and point to the $32 million refund that Phillips and Getty have agreed under their settlements to make to Northwest's consumers in the event of a jurisdictional determination by this Court. However, these settlements were made after the decision of the Fifth Circuit and represent a substantial compromise of past refund liability given in return for Phillips' and Getty's agreement to accept in the future regulated pricing, including an "old gas" price, less North-

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[7] Last year, the city of Washington, D.C. consumed 292,354,000 therms of natural gas. At the 1983 consumption rate, 3 Tcf would supply the city of Washington for more than 100 years.

[8] The Commission unquestionably has the power to order refunds in this case, and could restructure the agreements from their inception, as it did in the *Rayne Field* remedy case. Public Service Comm'n of New York v. FPC, 543 F.2d 757 (D.C. Cir. 1974), *cert. denied*, 424 U.S. 910 (1976). Petitioners and the FERC Staff have sought refunds only back to 1974 when producers were placed on notice of their liability. The 1974 Settlement Agreements provided that the payments made under the agreements were subject to Commission order in the event of a final jurisdictional determination. Even if the producers were somehow successful in fixing the commencement of their liability at the date of the FERC's jurisdictional decision in 1980, they would still be subject to refunds of about $500,000,000.

west's cost of producing the gas.[9] As a consequence, Phillips and Getty today are paid about 86¢ per MMBtu less Northwest's production costs per MMBtu for "old gas," whereas the GLA producers are receiving an incentive "new gas" price, now $3.35 per MMBtu less 7¢, for all gas, including "old gas."

In providing for incentive pricing under the NGPA, Congress never intended that producers in an established field, such as the San Juan Basin, could obtain such high prices for "old gas." Yet, this has happened and will continue to happen unless this Court closes the regulatory gap opened up by the court below.

2. The Lease Sales Were Jurisdictional Sales

Producers, citing the FERC Petition at 19, agree with the Commission that "the dispositive question [under *Rayne Field*] is whether what was sold was gas or merely the right to explore for gas." PLA Respondents' Brief at 13; Union Brief at 15. The producers claim that only the right to explore for gas was transferred under the GLA/PLA lease sales, even though the pipelines could not have been certificated, financed and built or expanded unless the GLA/PLA reserves were found to be proven[10] and immediately available upon completion of the

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[9] Phillips and Getty in effect accepted the pricing remedy for the future proposed by Northwest in the aborted FERC remedy case. The Commission found that "the settlement assures ratepayers secure future rates in return for the giving up of *substantial refunds* in the event the Former Fifth Circuit is reversed." 25 FERC ¶ 61,292 at 61,674 (1983) (italics added). The Commission was here referring to pre-1980 refunds. These two settlements provided for full refunds back to September 1980 contingent upon a final jurisdictional decision. Further, in the event of a jurisdictional determination, Phillips and Getty agreed that they may be required to accept a lower old gas price than is now used for valuing their old gas.

[10] As of 1951, the American Gas Association defined "proved reserves" as follows: "Proved reserves may be in either the drilled or undrilled portions of a given field. Where the undrilled areas are considered proved, they are so related to the developed acreage and to the known field geology and structure that their productive ability is considered assured. Proved recoverable reserves of natural gas are the reserves estimated to be producible under present operating practices." Report of The Committee on Natural Gas

pipeline facilities to provide the certificated gas service.[11] Judge Benkin specifically found that the reserves under each GLA/PLA were proven,[12] the FERC adopted his findings, and, despite producers' obfuscations,[13] the Fifth Circuit did not upset the agency's expert finding that the reserves were proven. In the case of GLA 47, this Court can see that the acreage transferred by Delhi was proven from the map submitted by Tenneco.[14] Thus, producers' contention that merely rights to explore unproven lands rather than proven gas reserves were sold under the GLA/PLA transactions is in con-

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Reserves of the American Gas Association, Year Ended December 31, 1951. A prudent operator in a proven area will therefore always drill a commercial well. R. 908, 1507.

[11] In the San Juan Basin, a development well in the 1950s required 30 days or less to drill. The development wells were drilled while the pipelines' gathering systems were being extended. Neither producer nor pipeline drills development wells ahead of the time that the pipeline can tie into the well. *See* El Paso Petition, No. 83-1442, at 6 nn.3 and 4.

[12] App. 52a-56a, 106a-07a.

[13] An example is Tenneco's Brief at 7 n.15. DeGolyer & MacNaughten specifically found the GLA 47 reserves were proven, as discussed in the PGandE and SoCalGas Petition, No. 83-1443 at 10-11. The California companies were seeking yet additional supply in the Basin. The memorandum cited by Tenneco in note 15 makes the point that additional drilling was needed to prove up reserves *beyond* the then established field limits in order for the entire Blanco area to be proven. This drilling was underway. *See* note 14, *infra*. Another example is the PLA producers' characterization that Amoco's PLA acreage was "an awful lot of goat pasture." PLA Respondents Brief at 21 n.29. An Amoco witness testified before Judge Benkin that Amoco's predecessor Stanolind transferred proved reserves. R. 1909, R. 1920.

[14] Outlined in red on the map lodged by Tenneco with this Court are the Mesaverde field limits as determined by El Paso and the state of New Mexico in early 1952. Field limits delineate the areal extent of proven reserves. Delhi's acreage is colored blue on the map. R.21053 All blue acreage within the red line was proved, according to El Paso and the state of New Mexico (as well as Delhi), at the time. R. 21053 This acreage, according to Delhi, contained proven, recoverable reserves of 1.063 Tcf. R.9692 Subsequent drilling in the 1950s rapidly expanded the proven field limits to include several times the proven area shown on the map. El Paso and Northwest conclusively showed that proven reserves were assigned under each GLA/PLA transaction. *E.g.*, R. 9971-10038.

flict with the findings of the agency accepted below. These agency findings, supported by substantial evidence, were conclusive on the court below. NGA § 19(b), 15 U.S.C. § 717r(b).

Because the GLA/PLA reserves were proven,[15] the producers knew the economics (reserves, capital cost, operating expense) of producing the gas, and therefore structured lease sales that returned to them the same net income that they would have received under conventional sales.[16] The cost of development drilling was simply one of a number of factors taken into account in calculating the payment to be received by the producers, just as in *Rayne Field*, *Bastian Bay*, and *Ship Shoal* (see appendix).[17] The FERC's findings of proven reserves and economic equivalence, both of which were accepted by the court below, means that the producers sold gas and not the right to explore for gas through the lease sale transfers. *See* App. 109a-110a. The absence of any particular number of development wells cannot change this dispositive fact.

[15] See definition of proven reserves in note 10, *supra*.

[16] Delhi's studies demonstrating this fact are in evidence (R. 9692, R. 5130); Union's predecessor made the same determination (R. 20787); Skelly estimated that it would receive two cents more per Mcf than under a conventional wellhead sale (R. 12870); C. E. Turner, a Phillips economist, testified that the lease sale "was just about as good or better than [Phillips] could [obtain] by drilling the acreage [itself], and selling the gas from day to day." R. 14279.

[17] Producers here seek to distinguish the trilogy on various hairsplitting grounds that the expert agency rejected as without merit. App. 105a-107a. For example, the only purpose of the "upfront" payment in Ship Shoal was to reimburse the producers for capital investment, just like the payments for existing wells here. R. 5149 In fact, the GLA 47 and Ship Shoal transactions are remarkably close, as shown by the Appendix to this Reply. Producers also misstate the facts of Ship Shoal; at closing, 12 wells, not 17, had been drilled: "One gas well has been completed; it has been and still is shut-in with no gas produced (J.A. 4-5). Seven oil wells have been completed and have been producing since 1960 (ibid.). Four dry holes had been drilled (ibid.)." Producers' Petition for Certiorari, Continental Oil Co. v. FPC, No. 1323, October Term, 1966, pp. 3-4; see also Tennessee Gas Transmission Co., 30 F.P.C. 759, 799 (1963). The five potential gas wells were drilled by the pipeline after closing, not by the producers. 30 F.P.C. at 803.

Producers do not attempt to defend the Court of Appeals' decision that in order for a lease sale of gas to be jurisdictional there must be present on the leasehold sufficient development wells to deplete the proven reserves. Rather, producers argue that unless substantial development exists the lease sale fails the proven reserve requirement or the economic equivalent test. Tenneco contends that unless substantial development exists "a sale of gas in place is impossible because a definable volume of gas is uncertain, and estimates of reserves cannot be relied upon by the parties to the transfer." Tenneco Brief at 13. Similarly, the PLA producers maintain that this Court in *Rayne Field* required substantial development for "verification of the estimated reserves thought to underlie the acreage" in order to have a sale of gas. PLA Respondents' Brief at 14. On the other hand, Union, alone in acknowledging the lower court's treatment of substantial development as a jurisdictional requirement, separate and apart from whether reserves are proven, asserts that if the "risks and expenses" of development wells[18] are transferred to the buyer "then the lease sale simply cannot be economically equivalent to the sale of gas." Union Brief at 16, 17.

The failure of the producers directly to defend the decision below underscores its gross misapplication of *Rayne Field*. In fact, under the Tenneco-Phillips rationale, *Rayne Field* could *never* have been a jurisdictional lease sale. In 1959, at the time of that lease sale, "a major unknowable was the volume of gas which the transferred reserves would ultimately yield, and consequently the eventual unit price which Texas Eastern would pay for the yield." *Public Service Comm'n of New York* v. *FPC*, 543 F.2d 757, 783 (D.C. Cir. 1974), *cert. denied*, 424 U.S. 910 (1976) (*Rayne* remedy case).[19] In connection with

[18] When the reserves are proven, there is no significant risk in drilling development wells. See note 10, *supra*. The risk is in drilling exploratory wells, *not* development wells. R.908.

[19] The producers, as well as the Fifth Circuit, know that reserve estimates vary considerably and that substantial development is not required to verify proven reserve estimates traditionally relied upon by producers, pipelines the Commission, and lenders. See Ship Shoal, 370 F.2d at 65 ("We recognize

Union's position, the evidence here showed that the producers structured the economic equivalent of a conventional sale without development wells,[20] and the court below never disputed the agency's finding of equivalence.

It is indefensible to deny jurisdiction over lease sales which the Commission found based on substantial evidence to be assignments of proven reserves that were economically equivalent to conventional sales simply because the pipelines were required by the producers to drill the development wells. If primary jurisdiction means anything, the court below should surely have deferred to the agency's judgment that development drilling was not needed here to accomplish jurisdictional sales of gas by these lease sales.[21]

3. Producers Are Not Royalty Owners

Producers here seek refuge under the *Mobil* case.[22] They contend that they are nothing more than passive royalty owners who engaged in unregulated land transactions even though such royalty owners typically are paid on 12½% of the value of the production, whereas the GLA and PLA producers are paid on 70% to 85% of the value of the production. True royalty owners, such as the respondent farmers in the market value royalty cases currently pending before this Court,[23] under-

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that estimates of reserves in Ship Shoal may vary considerably until the field is fully drilled and there is productive history over a period of years under operating conditions.").

[20] See note 16, *supra*.

[21] In Ship Shoal, the producers also argued that the reserves were unproven, and there were no gas development wells. Nevertheless, the court affirmed the agency's jurisdictional determination without any development wells because of the purchasing pipeline's "willingness to invest over $97 million on its faith in the lowest of the reserve estimates" and because "its readiness to connect its lines to *Ship Shoal* is a strong indication that the field was 'substantially developed' at the time of transfer." 370 F.2d at 65. The GLA/PLA transactions had similar and considerably more persuasive facts.

[22] Mobil Oil Corp. v. FPC, 463 F.2d 256 (D.C. Cir. 1971), cert. denied, 406 U.S. 976 (1972).

[23] Nos. 83-1234, 83-1248 & 83-1278.

stand the vast difference between themselves and the producers. As the farmers inform this Court:

> Overriding royalty interest owners, as sellers of gas or leases, such as producer-respondents in Nos. 83-1321, 83-1433 and 83-1618, may of course be subject to the Commission's jurisdiction under the National Gas Act. Not even a transparent similarity exists between respondent landowners' rental involved herein and the producers' overriding royalty interests as lessees in Nos. 83-1321, 83-1433 and 83-1618.[24]

Because the GLA/PLA producers are paid on the entire net interest assigned, they are capturing more than 400% of the regulated value of the gas, as opposed to the situation in the market value royalty cases where several of these same producers complain about the landowner capturing 60% of the regulated value.[25] The GLA/PLA reserves remain a major and necessary gas supply for western gas markets. It is imperative that this Court ensure that the producers' continuing exploitation of consumers and pipelines dependent on this supply be brought to a halt.

4. Conclusion

The petitions should be granted.

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[24] Brief of Respondents in Opposition, Ashland Oil Co. v. Good, et. al., Nos. 83-1234, 83-1248 & 83-1278 at 21 n.18.

[25] See FERC Petition for Cert., FERC v. Tenneco Oil Co., No. 83-1618 at 22 n.17, where the FERC explains that the financial impact here far exceeds that in the market value royalty cases.

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May 21, 1984

APPENDIX

Comparison of GLA 47/Ship Shoal

	GLA 47	Ship Shoal
1. Recoverable Reserves As Estimated By Producer *Before* Lease Sale Execution	1.063 Tcf (R.9692)	730 to 823 Bcf (370 F.2d at 65)
2. Reserves Producible In Four Years As Estimated By Producer	16.8% (or 179 Bcf) (R.9692)	10% (or 73 to 82.3 Bcf) (370 F.2d at 66)
3. Estimated Life Of Property	25 years (R.9692)	26 years (30 F.P.C. at 803)
4. Specified Development Program	Yes (R.4098-101)	Yes (R.14169)
5. Capital Investment[1] Over Life Of Reserves	$20,000,000 (R.9692)	$13,104,000 (30 F.P.C. at 803)[2]
6. Capital Investment At Closing	$1,021,000 (R.5149)	$1,999,000 (30 F.P.C. at 803)
7. Closing Payment[3]	$1,021,000 (R.5149)	$1,925,000 (30 F.P.C. at 801)
8. Pipeline Operating Expense Over Life Of Reserves As Estimated By Producer	$595,000 (R.9692)	$31,009,000 (30 F.P.C. at 803)
9. Method Of Payment	Cents Per Mcf as produced	Advance payments as scheduled by notes

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[1] As used in this comparison, "capital investment" means the amount invested in depreciable gas property.

[2] $1,999,000 at closing ($2,280,000 × 87.6712%) + 8,260,000 + 2,845,000. 30 F.P.C. at 803.

[3] The producers call this the "upfront payment." It is exactly the same as capital investment at closing in GLA 47 and nearly the same in Ship Shoal.

Comparison of GLA 47/Ship Shoal

	GLA 47	Ship Shoal
10. Reserve Redetermination	No[4]	Yes,[5] in 7th year
11. Overall Consideration For Reserves	Net interest payment[6] (geared to production) + capital and operating costs shifted to pipeline	Net interest payment (geared to production) + capital and operating costs shifted to pipeline

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[4] Not needed as payment per Mcf.

[5] The purpose was to enable the parties to readjust the price depending on remaining reserves as estimated upon significant production history.

[6] In jurisdictional lease sale transfers of the type involved here, the producer assigns the working interest to the pipeline, and the pipeline then bears the royalty expense. The producer is paid on the entire volume remaining after subtraction of royalty volume. This payment at least in the early years is less than the field or in-line price in recognition that under the lease sale form capital and operating costs have been shifted to the pipeline.